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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 328

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

R. J. REYNOLDS TOBACCO COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 6, 1938

CERTIORARI GRANTED OCTOBER 17, 1938

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 328

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VS.

R. J. REYNOLDS TOBACCO COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

INDEX

1 BEFORE UNITED STATES BOARD OF TAX APPEALS

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: D. H. Blair, Esq., M. A. Braswell, Esq., J. G. Korner, Jr., Esq. For Comm'r: Arthur H. Fast, Esq., E. C. Adams, Esq., B. M. Brodsky, Esq.

Docket entries

1933

May 4—Petition received and filed. Taxpayer notified. Fee paid.

May 5—Copy of petition served on General Counsel.

June 27—Answer filed by General Counsel.

July 6—Copy of answer served on taxpayer.

1935

Sept. 9—Hearing set Oct. 30, 1935.

Sept. 18—Motion for continuance to a day not earlier than Dec. 1, 1935, filed by taxpayer.

Sept. 19—Motion for continuance granted and continued to January 13, 1936.

1936

Jan. 4—Motion for a continuance to a date not earlier than February 24, 1936, filed by taxpayer.

Jan. 6—Motion for continuance to a date not earlier than Feb. 24, 1936, granted and continued to Feb. 24, 1936.

Feb. 12—Motion for continuance to March 16, 1936, filed by General Counsel. 2/12/36. Granted.

Feb. 13—Motion for leave to file amended answer, amendment lodged, filed by General Counsel. 2/15/36. Granted.

Mar. 7—Motion for continuance to 4/26/36 filed by taxpayer. Granted.

Mar. 14—Reply to amended answer filed by taxpayer. 3/16/36 copy served on General Counsel.

Apr. 18—Application for subpoena to James A. Gray and S. Clay Williams filed by General Counsel.

2 Apr. 18—Subpoena to James A. Gray issued.

Apr. 18—Subpoena to S. Clay Williams issued.

Apr. 27—Hearing had before Mr. Van Fossan on merits. Submitted. Petitioners and respondent's motions filed. Stipulation of facts filed. Subpoena to S. Clay Williams filed. Respondent's brief due 5/27/36. Petition's reply June 27, 1936, Respondent reply July 13, 1936.

Apr. 27—Petitioner's motion for order granting petitioner the opportunity to present and claim proper deductions at the settlement of final deficiency under Rule 50—Granted.

1936

Apr. 28—Transcript of hearing of April 27, 1936, filed.

May 6—Motion to correct transcript of record of the hearing on April 27, 1936, filed.

May 6—Motion to correct transcript of record of the hearing on April 27, 1936, granted.

May 23—Brief filed by General Counsel.

May 23—Respondent's rejoinder to petitioner's reply to amended answer of respondent, filed.

June 5—Brief filed by taxpayer. 10/5/36 copy served on General Counsel.

1937

Feb. 19—Motion for additional authority supporting petitioner's contentions filed by taxpayer. 2/19/37 copy served on General Counsel.

Apr. 27—Findings of fact and opinion rendered, E. H. Van Fossan, Div. 9. Decision will be entered under Rule 50.

June 17—Notice of settlement filed by General Counsel.

June 19—Hearing set July 14, 1937, on settlement under Rule 50.

July 14—Hearing had before Mr. Miller, Div. 16, on settlement under Rule 50. Not contested—Referred to Mr. Van Fossan, Div. 9, for decision.

July 16—Decision entered—Eugene Black, Div. 15.

Oct. 12—Petition for review by United States Circuit Court of Appeals, 4th Circuit, with assignments of error filed by taxpayer.

3 Oct. 12—Proof of service filed.

Dec. 2—Agreed statement of evidence approved and ordered filed.

Dec. 2—Agreed *praecipe* with proof of service thereon filed.

Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed May 4, 1933

Comes now the petitioner and appeals from the determination by the Commissioner of an alleged deficiency, as set forth in his deficiency notice dated April 3, 1933 (IT:AR:C-4:HLL-60D), and prays the Board to review and redetermine the tax liability of the petitioner in accordance with law. The petitioner alleges:

I

Petitioner is a New Jersey corporation with its principal office and place of business in Winston-Salem, North Carolina, which is in the Collection District of North Carolina.

II

The notice of deficiency (copy of which is hereto attached and marked Exhibit A) was mailed to the petitioner on April 3, 1933.

III

The tax in controversy is income tax for the calendar year 1929 and is in the amount of $15,990.65.

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IV

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erroneously added to petitioner's net income $145,369.52 (being $145,475.44 less a minor adjustment of $105.92) alleging the same to be a profit realized in a liquidation or a liquidating dividend, when the transaction in question constituted a reorganization (giving rise to no gain), wherein under the plan of reorganization the petitioner acquired all the assets of another corporation.

(b) The Commissioner, in computing the alleged profit, alleged by himself to have been realized by petitioner as aforesaid, erroneously assumed $100,719.92 to have been the cost of the stock which he alleges was exchanged for the assets in question; whereas the cost of the said stock was $174,998.32.

V

Petitioner alleges the following facts:

(a) Petitioner is, and was during the taxable years 1927, 1928, and 1929, a New Jersey corporation, with its principal office and place of business in Winston-Salem, North Carolina, and is engaged in the manufacture of cigarettes and other tobacco products. In its business as aforesaid the petitioner uses a large amount of foil for wrapping its products.

(b) In 1927 there was situate at Richmond, Virginia, a Virginia corporation, the Tobacco Foil Company, which manufactured foil used by petitioner and was the chief source of supply of the foil so used by petitioner.

(c) Tobacco Foil Company owned a plant in Richmond, Virginia, in which it manufactured its product. This plant was equipped with the machinery and other equipment designed for and used in the manufacture of its foil product, which was of a high grade and quality.

5 (d) Petitioner desired to manufacture its own foil and in order to accomplish this result it sought to purchase the assets of Tobacco Foil Company and to remove such assets to Winston-Salem, North Carolina, and there to install those assets (exclusive of real estate) in petitioner's plant in Winston-Salem, and to manufacture for its own use the foil then being manufactured by Tobacco Foil Company.

(e) Substantially all of the capital stock of Tobacco Foil Company was owned by S. Q. Kline, R. B. Campbell, and W. E. Gaines, who constituted the officers and board of directors of that company. Petitioner entered into negotiations with the said officers and directors the plan being the purchase of the assets of the Tobacco Foil Company and the employment by petitioner of Messrs. Kline, Campbell, and Gaines to operate the said assets after their removal to petitioner's plant in Winston-Salem, N. C. Accordingly petitioner made a proposal to the directors of Tobacco Foil Company in accordance with the said plan.

(f) As the negotiations proceeded the plan of the petitioner was effected in the following manner: On June 3, 1927, a contract was executed between the petitioner and Messrs. Kline, Campbell, and Gaines by the terms of which petitioner acquired from said Kline, Campbell, and Gaines all the capital stock of Tobacco Foil Company for the sum of $174,998.32 in cash. The contract further provided that Messrs. Kline, Campbell, and Gaines would dismantle the plant in Richmond, Virginia, and remove all the assets of Tobacco Foil Company (except the real estate in Richmond, Va.), to Winston-Salem, N. C., and install such assets in the plant of petitioner in said city; that said Kline, Campbell, and Gaines would install the said assets in petitioner's plant in Winston-Salem, N. C., and supervise the operation thereof and instruct the employees of petitioner in said operation for a period of not less than six months after completion of said installation and commencement of operation of the assets in petitioner's plant; that said Kline, Campbell, and Gaines would be paid salaries for such services from and after July 1, 1927.

(g) The plan of the petitioner was to secure the assets of
6 Tobacco Foil Company and install them in its own plant in Winston-Salem, N. C.; to secure the services of Messrs. Kline, Campbell, and Gaines in installing and instructing petitioner's employees in the operation of the said assets; to dissolve the Tobacco Foil Company when this had been accomplished.

(h) Thereafter, and in accordance with the plan above outlined, and pursuant to the intent and purpose of said plan, the plant of Tobacco Foil Company at Richmond, Va., was dismantled and the machinery and equipment removed therefrom to the plant of the petitioner at Winston-Salem, N. C., under the supervision and direction of Messrs. Kline, Campbell, and Gaines, who continued their employment in installing and setting up the said assets for operation in petitioner's plant and thereafter instructed the employees of petitioner in the operation thereof.

(i) Thereupon, in April 1929 the petitioner caused the taking over of the assets which had theretofore been accomplished, as aforesaid, to be ratified by formal documents of conveyance and thereupon caused the Tobacco Foil Company to be dissolved.

(j) The matters and things done as aforesaid all constituted a part and parcel of one plant whereby petitioner acquired all of the assets of Tobacco Foil Company, and each step taken to that end

was a step in the said plan and pursuant thereto, and constituted a statutory reorganization.

(k) The petitioner realized no gain in the said transaction and no gain is recognized on the transaction under the statute.

And, as another and further defense to the proposed deficiency asserted by the Commissioner, the petitioner alleges:

(l) The cost of all the stock of Tobacco Foil Company, acquired by petitioner as above herein set out, was $174,998.32 in cash.

7 (m) The assets taken over by petitioner from Tobacco Foil Company had a net worth in an amount not greater than $246,195.36.

(n) The Commissioner has proposed to increase the net income of petitioner on account of the foregoing transaction, in the amount of $145,475.44 (less an uncontested adjustment for depreciation of $105.92), or in the net amount of $145,369.51, and on said last amount has computed (at 11% rate) a proposed deficiency in tax of $15,990.65.

(o) The action of the Commissioner is erroneous and without warrant or justification in law.

Wherefore the petitioner prays that the Board may hear this cause and determine and decide that there is no deficiency due from the petitioner on account of income taxes for the year 1929.

(s) D. H. Blair,
(s) M. A. Braswell,
(s) J. G. Koiner, Jr.,

Transportation Bldg., Washington, D. C.

[*Duly sworn to by S. Clay Williams; jurat omitted in printing.*]

8 Exhibit "A" to petition

Treasury Department,
Washington, Apr. 3, 1933.

IT:AR:C-4
HLL-60D

R. J. Reynolds Tobacco Company,
Main and Fourth Streets,
Winston-Salem, North Carolina.

Sirs: You are advised that the determination of your tax liability for the year(s) 1929 discloses a deficiency of $15,990.65, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the

accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; whereas if this form is not filed, interest will accumulate to the date of the assessment of the deficiency.

Respectfully,

DAVID BURNETT,
Commissioner.

By (Signed) W. T. SHERWOOD,
Acting Deputy Commissioner.

Inclosures:
Statement
Form 870. IJ-1.

9 STATEMENT

IT:AR:C-4
HLL-60D

In re: R. J. Reynolds Tobacco Company, Main and Fourth Streets, Winston-Salem, North Carolina.

INCOME TAX LIABILITY

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1929	$4,234,676.17	$4,218,685.52	$15,990.65

The report of the internal revenue agent in charge, Greensboro, North Carolina, a copy of which was furnished you, is approved and is hereby made a part of this letter.

Careful consideration has been accorded your protests dated February 2, 1932, and April 30, 1932, and the information submitted at the conference held in this office on February 17, 1932, and July 8, 1932. It is held by this office that a profit of $145,475.44 resulted from the purchase and subsequent liquidation of the Tobacco Foil Products Company.

A copy of this communication has been furnished your representative, Mr. Jules G. Koiner, Jr., Transportation Building, Washington, D. C., who has on file in this office a duly recorded power of attorney.

Consents which will expire June 30, 1934, are on file for the year 1929.

IJ-1

Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed June 27, 1933

Comes now the respondent by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and in
10 answer to the petition of the petitioner, admits, denies and alleges as follows:

I, II, and III. Admits the allegations contained in paragraphs one, two, and three of the petition.

IV. (a) and (b) Denies that the respondent committed errors as alleged in paragraph four (a) and (b) of the petition.

V. (a), (b), and (c) Admits the allegations contained in sub-paragraphs (a), (b), and (c) of paragraph five of the petition.

V. (d), (e), (f), (g), (h), and (i) Denies each and every allegation contained in sub-paragraph (d), (e), (f), (g), (h), and (i) of paragraph five of the petition, which is contrary to or inconsistent with the determination of the Commissioner as set forth in the notice of deficiency.

V. (j), (k), (l), and (m) Denies the allegations contained in sub-paragraphs (j), (k), (l), and (m) of paragraph five of the petition.

V. (n) Admits the allegations contained in paragraph five (n) of the petition.

V. (o) Denies the allegations contained in paragraph five (o) of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and the Commissioner's determination of deficiency be approved.

(Signed) E. BARRETT PRETTYMAN,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
DEWITT M. EVANS,
Special Attorney,
Bureau of Internal Revenue.

11 Before United States Board of Tax Appeals

[Title omitted.]

Amended answer

Lodged February 13, 1936

Filed Feb. 15, 1936

Comes now the Commissioner of Internal Revenue, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for amended answer to the petition filed herein admits, denies, and alleges as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits that the tax in controversy is income tax for the calendar year 1929, but denies that the amount in controversy is $15,990.65.

IV. Denies that the respondent committed the errors as alleged in paragraph IV of the petition.

V-(a), (b), and (c). Admits the allegations contained in paragraphs V-(a), (b), and (c) of the petition.

(d) to (m), inclusive. Denies the allegations contained in paragraphs V (d) to (m), inclusive, of the petition.

12 (n) Admits the allegations contained in paragraph V (n) of the petition.

(o) Denies the allegations contained in paragraph V (o) of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified, or denied.

VI. The respondent desires to raise an affirmative issu [illegible]ein-after indicated. With respect to such affirmative issue, the [illegible]ent alleges as follows:

(a) That during the year 1921 the petitioner, the R. J. Reynolds Tobacco Company, began trafficking (that is, buying and selling) in Class B common stock of the R. J. Reynolds Tobacco Company, i. e., its own stock. This trafficking in a considerable volume continued throughout the years 1921 to 1933, inclusive.

(b) That during the year 1929 the R. J. Reynolds Tobacco Company, through the Equitable Trust Company, New York, New York, sold in the open market 15,000 shares Class B common stock of the R. J. Reynolds Tobacco Company for a net sales price of $708,690.00, which shares had been acquired subsequent to January 1, 1921, by the said R. J. Reynolds Tobacco Company through its so-called nominee account entitled Robert S. Campbell. The net cost of these 15,000 shares of Class B common stock of the R. J. Reynolds Tobacco Company to the said R. J. Reynolds Tobacco Company was $121,440.19. The taxable profit realized by the said R. J. Reynolds Tobacco Company from trafficking in these shares was $587,249.81.

(c) That during the year 1929 the R. J. Reynolds Tobacco Compa[illegible], through the Equitable Trust Company, New York, New York, and various brokers, sold in the open market 94,500 shares of Class B common stock of the said R. J. Reynolds Tobacco Company

13 for a net sales price of $4,506,497.00, which shares had been acquired subsequent to January 1, 1929, by the said R. J. Reynolds Tobacco Company through its so-called nominee account entitled Edward C. Kenny. The net cost of these 94,500 shares of Class B common stock of the said R. J. Reynolds Tobacco Company to the said R. J. Reynolds Tobacco Company was $4,908,966.17. The loss realized by the said R. J. Reynolds Tobacco Company from trafficking in these shares was $402,469.17. The deductibility of this loss is conceded only if the affirmative issues raised herein be sustained.

(d) That during the year 1929 the R. J. Reynolds Tobacco Company through the Equitable Trust Company, New York, New York, and various brokers, sold in the open market 99,500 shares of Class B common stock of the said R. J. Reynolds Tobacco Company for a net sales price of $4,703,608.00, which shares had been acquired subsequent to January 1, 1929, by the said R. J. Reynolds Tobacco Company through its so-called nominee account entitled Horace E. Whitney. The net cost of these 99,500 shares of Class B common

stock of the R. J. Reynolds Tobacco Company to the R. J. Reynolds Tobacco Company was $4,601,807.43. The taxable profit realized by the said R. J. Reynolds Tobacco Company through trafficking in these shares was $101,800.57.

(e) That neither the purchases and sales or any of them of the Class B common stock of the R. J. Reynolds Tobacco Company by the said R. J. Reynolds Tobacco Company (as alleged above) were made in connection with any transaction whereby the total outstanding stock and/or bonds of the said R. J. Reynolds Tobacco Company was increased or diminished; furthermore that neither such purchases and sales or any of them was made in connection with any transaction whereby any of the said Class B common stock was retired or cancelled or any of the assets of the said R. J. Reynolds Tobacco Company was liquidated. In short the shares of stock above mentioned were not acquired or parted with in connection with a readjustment of the capital structure of the R. J. Reynolds Tobacco Company; that the purchases and sales were recorded in the investment account of the petitioner and were reflected in its profit and loss account and
14 in its surplus account; and that none of these purchases and sales during 1929 was reflected in the capital stock account of the R. J. Reynolds Tobacco Company.

(f) That the net taxable profit realized during the year 1929 by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company (as indicated in paragraphs (b), (c), and (d) supra, was $286,581.21.

(g) That a net income for 1929 of $38,497,056.05 formed the basis of the notice of deficiency dated April 3, 1933, from which this appeal was taken. Such net income should be increased by the sum of $286,581.21 representing the taxable profit realized by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company.

Wherefore, it is prayed that the net income of the R. J. Reynolds Tobacco Company for the year ended December 31, 1929, as shown in the notice of deficiency dated April 3, 1933, of $38,497,056.05, be increased by the sum of $286,581.21, representing the net profit realized by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company; and that the tax, as shown in said notice of deficiency dated April 3, 1933, be ordered recomputed and that the deficiency of $15,990.65 as shown in said notice be increased accordingly. Claim for said increased deficiency is hereby made under the provisions of Section 272 (e) of the Revenue Act of 1928.

(Signed) HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

Of Counsel:
A. H. FAST,
PAUL E. WARING,
Special Attorneys,
Bureau of Internal Revenue.

AHF-PEW-fw-1-18-36.

15 Before United States Board of Tax Appeals

[Title omitted.]

Petitioner's reply to amended answer of respondent

Filed March 14, 1936

Comes now the petitioner, and for reply to the Amended Answer of Respondent, filed in this cause, admits, denies, and alleges as follows:

VI. (a) Denies the allegations as set forth in paragraph VI (a) of the Amended Answer, except that it is admitted that in the year 1921, the petitioner acquired for cash certain certificates representing shares of Class B Common Stock of the R. J. Reynolds Tobacco Company.

(b) Denies the allegations as set forth in paragraph VI (b) of Respondent's Amended Answer, except that it is admitted that during the year 1929, the petitioner cancelled certificates held by it representing 15,000 shares of Class B Common Stock of R. J. Reynolds Tobacco Company which it had acquired for cash in the year 1921, as aforesaid, and issued in lieu thereof new certificates representing 15,000 shares of the said stock to divers persons who paid into the treasury of the petitioner in the year 1929, the sum of $708,690.00, in cash, in consideration for the issuance to them of the said new certificates representing 15,000 shares of the said Class B Common Stock of R. J. Reynolds Tobacco Company; and it is further admitted that the acquisition by the petitioner of the said certificates representing the said 15,000 shares of Class B Common Stock, which occurred in the year 1921, was for cash in the amount of $121,440.19.

16 (c) Denies the allegations as set forth in paragraph VI (c) of Respondent's Amended Answer, except that it is admitted that in the year 1929 the petitioner acquired for cash, in the amount of $4 908 966.17, certificates representing 94,500 shares of Class B Common Stock of R. J. Reynolds Tobacco Company, and that later in the same year 1929, the petitioner cancelled the said certificates so acquired by it, as aforesaid, and issued in lieu thereof new certificates representing 94,500 shares of Class B Common Stock to divers persons who paid into the treasury of the petitioner in the year 1929, the sum of $4,506,497.00 in cash, in consideration for the issuance to them of the said new certificates representing 94,500 shares of the said Class B Common Stock of R. J. Reynolds Tobacco Company.

(d) Denies the allegations as set forth in paragraph VI (d) of Respondent's Amended Answer, except that it is admitted that in the year 1929 the petitioner acquired for cash, in the amount of $4,691,807.43, certificates representing 99,500 shares of Class B Common Stock of R. J. Reynolds Tobacco Company, and that later in the same year 1929 the petitioner cancelled the said certificates so acquired by it, as aforesaid, and issued in lieu thereof new certificates representing 99,500 shares of Class B Common Stock to divers persons who paid into the treasury of the petitioner in the year 1929 the sum of

$4,703,608.00 in cash in consideration for the issuance to them of the said new certificates representing 99,500 shares of the said Class B Common Stock of R. J. Reynolds Tobacco Company.

(e) Denies the allegations as set out in paragraph VI (e) of Respondent's Amended Answer, except that it is admitted that from the time of the acquisition of the certificates representing shares of Class B Common Stock until the time of their cancellation and the issuance of new certificates in lieu thereof, as set out above in paragraphs VI (a), (b), c), and (d) of this Reply, the said certificates were entered and recorded on the books and records of the petitioner, not as a current asset but in an account designated as "Investments in non-competitive companies," in which said account they were entered at the amounts of money for which they were so acquired; and it is further admitted that the stock books and stock records of the petitioner in
17 which were recorded the number of shares of its capital stock (Class B Common Stock) indicated that throughout the year 1929, the number of issued and outstanding shares of Class B Common Stock was at all times 9,000,000 shares.

(f) Denies the allegations contained in paragraph VI (f) of Respondent's Amended Answer.

(g) Denies the allegations as set forth in paragraph VI (g) of Respondent's Amended Answer, except that it is admitted that the Commissioner determined and asserted in his statutory deficiency notice of April 3, 1933 (the so-called 60-day letter), from which the instant appeal was taken, that the net income of petitioner for the year 1929 was $38,497,056.05, and that on that basis the Commissioner computed the deficiency from which this petitioner appealed to the Board on May 4, 1933.

VII. Petitioner, for further reply and defense to the issue raised by the respondent in paragraph VI of his Amended Answer, alleges:

(a) Petitioner was not a trafficker or dealer in the stocks of any corporation and petitioner did not traffic or deal in its own stock or the stock of any other corporation, and did not so traffic or deal in its own stock in the year 1929.

(b) In the year 1921 and in the year 1929 the petitioner had acquired, and did acquire, for cash, certificates representing shares of Class B Common Stock of R. J. Reynolds Tobacco Company, which were later cancelled and new certificates issued in lieu thereof for cash, as hereinabove set out, and on each such occasion the transaction was for good and sufficient reasons which were connected with the protection and conservation of petitioner's business and of its capital structure, and was, on each such occasion, pursuant to sound business judgment connected with policy and policy matters of grave importance to the petitioner, which were entirely independent of, and were wholly distinct and separate from gain or loss, if any, which might result from such transaction: that such transactions were not a part of, and did
18 not constitute a business operation of the petitioner, whose business is confined solely to the manufacture and sale of cigarettes, smoking tobacco, and other tobacco products, and its business and busi-

ness operations do not include or comprehend trafficking or dealing in stocks or securities.

(c) None of the transactions set out in paragraphs VI and VII of this Reply, and referred to by respondent in paragraph VI of his Amended Answer, were transactions in which petitioner acquired or disposed of an asset or bought and sold an asset, and in none of said transactions did petitioner acquire or dispose of an asset or buy and sell an asset; and in none of said transactions did petitioner realize a taxable profit and no tax arises by, upon, or out of any of the said transactions.

(d) All of the transactions occurring in the year 1929, which give rise to the issue raised by the respondent in paragraph VI of his Amended Answer, were made under and pursuant to the Revenue Act of 1928 and the Regulations duly promulgated under and pursuant to that said Act, and were made in light of the provisions of that said Act and of those said Regulations and of the opinions, rulings, decisions, judgments, and decrees of the Secretary of the Treasury, of the Commissioner of Internal Revenue, of the General Counsel of the Bureau of Internal Revenue, of the Board of Tax Appeals, and of various courts and tribunals, all of which specifically ruled and held that a corporation did not realize a taxable profit nor sustain a deductible loss solely upon the acquisition by it of shares of its own stock or upon the issuance or disposal by it to others of such shares of its own stock.

(e) The Revenue Act of 1928, as well as revenue acts prior thereto and revenue acts subsequent thereto, was enacted by the Congress in light of the long continued regulations, rulings, opinions, and decisions, as aforesaid, and in such enactments the Congress adopted, affirmed, and incorporated such rulings and decisions into the aim, purpose, and intendment of the Revenue Act of 1928, and petitioner alleges that such was the aim, purpose, intendment, and enactment of
19 the Revenue Act of 1928, as is further evidenced by the Regulations promulgated pursuant to and under the authority of the said Revenue Act of 1928, and of the next ensuing Revenue Act of 1932, and the Regulations promulgated pursuant thereto; and by its said repeated and long-standing enactments Congress aimed, purposed, intended, and enacted by the Revenue Act of 1928 that no gain should be realized and no loss should be sustained by a corporation upon its acquisition, for cash, and its reissuance, for cash, of shares of its own stock or of certificates representing shares of its own stock.

(f) The attempt of the Commissioner to assert and assess a tax upon profits alleged by him to have arisen by, upon, or out of such said transactions is an attempt to amend the Revenue Act of 1928 by administrative fiat and without legislative sanction, approval or enactment, and is an attempt to apply such an amendment, promulgated by himself with the approval of the Secretary on May 2, 1934, as Treasury Decision #4430, retroactively to the year 1929; and the petitioner further alleges that the Regulation under which the respondent now purports to act, as aforesaid, even though it were a valid Regulation and amendment to the statute, which petitioner

denies, does not impose, give rise to, or support a tax upon the transactions hereinabove set out, and that such said transactions are not made taxable by the provisions of such said purported or attempted amendment.

(g) The transactions which occurred in the year 1929, as hereinabove set out by the petitioner, were completed and closed transactions in the said year 1929; that, as petitioner is informed, advised and believes, in the year 1929 many thousands of taxpayers made similar transactions pursuant to and in the light of the Revenue Act of 1928, and the Regulations, rulings and decisions pertaining thereto, whose said transactions have not been questioned and upon which no tax has been asserted or attempted to be asserted; that, as petitioner is informed, advised and believes, the action of the respondent in his Amended Answer, in asserting a tax upon the predicate that it arose out of the transactions made by the petitioner in 1929, as hereinabove set out, is violative of law, and is violative of the fundamental principle of uniformity of taxation, and
20 is violative of the provisions of the Constitution of the United States.

Wherefore, the petitioner prays that respondent's appeal, as set out in paragraph VI of his Amended Answer be denied; that the Board hear this cause and determine and decide that there is no deficiency due from the petitioner on account of income taxes for the year 1929.

M. A. Braswell,
D. H. Blair,
J. G. Korner, Jr.,
Council for Petitioner.

401 Transportation Building, Washington, D. C.

Before United States Board of Tax Appeals

[Title omitted.]

Respondent's rejoinder to petitioner's reply to amended answer

Filed May 23, 1936

Comes now the Commissioner of Internal Revenue by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for rejoinder to petitioner's reply to amended answer of respondent, pleads as follows:

Respondent desires to stand on that portion of Rule 18 of the Board's Rules of Practice which states:

"Any new or affirmative matter contained in the reply is to be deemed to be denied,"

in all respects save only one. Said exception is as follows:
21 Respondent admits that the transactions which occurred in the year 1929 were completed and closed transactions in the said year 1929 as is alleged in paragraph VII (g) of petitioner's reply.

Respondent files the instant rejoinder in compliance with Rule 32 of Board's Rules of Practice, revised to July 1, 1935, inasmuch as the aforesaid admission was made orally during the trial of this cause on April 27, 1936 (R. 8 and 9), and is hereby reduced to writing as required by the aforesaid Rule 32.

(Signed) HERMAN OLIPHANT,
General Counsel for the Department of the Treasury.

Of Counsel:
A. H. FAST,
E. C. ADAMS,
Special Attorneys,
Bureau of Internal Revenue.

5-22-36.

Before United States Board of Tax Appeals

[Title omitted.]

Findings of fact and opinion

Promulgated April 27, 1937

Over a period of several years, in pursuance of its policy of broadening its stockholding base, protecting its stock and business, and to support the market, petitioner corporation bought shares of its own stock for cash on the open market and later sold certain of the shares so acquired. The stock was not retired but was held as treasury stock and carried in its investment account. During the taxable year 1929 petitioner so bought 574,000 shares. Also during the taxable
22 year petitioner sold 194,000 shares of its own stock acquired during 1929, and 15,000 shares previously acquired. These sales were for cash on the open market, each transaction of purchase or sale being handled in the same manner as ordinary commercial transactions of purchase and sale. Held: Petitioner's transactions were taxable transactions from which gain or loss resulted. Simmons & Hammond Manufacturing Co., 1 B. T. A. 803, overruled.

J. G. Korner, Jr., Esq., D. H. Blair, Esq., and M. A. Braswell, Esq., for the petitioner.

A. H. Fast, Esq., and E. C. Adams, Esq., for the respondent.

At its inception this proceeding involved a deficiency of $15,990.65, income taxes for 1929. The parties, however, have disposed of this deficiency by stipulation as hereinafter set forth. A new deficiency of $39,036.91 has been asserted by respondent in an amended answer based upon his determination that petitioner realized a taxable profit of $286,581.21 from sales of its own new class B common stock during 1929. Petitioner's reply challenges the correctness of this latest determination of respondent.

The record consists of a written stipulation of facts with attached documents as a part thereof, oral testimony, and exhibits received in evidence at the hearing.

FINDINGS OF FACT

The petitioner is a corporation organized in 1899 under the laws of the State of New Jersey. Its principal office and place of business is Winston-Salem, North Carolina. It is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco, and cigarettes.

From time to time since 1901 the capital structure of the corporation has been changed by increases in the common stock, by the issuance of new classes of common stock known as class B common, later eliminated in favor of new class B common, by the issuance and subsequent retirement of preferred stocks, by stock dividends, and by stock split-ups due to reduction in the par value of the common stock,
23 all of which is more particularly set forth in the stipulation submitted by the parties hereto. During the taxable year 1929 the total capitalization of R. J. Reynolds Tobacco Co. was:

1,000,000 shares common stock at $10 par value	$10,000,000
9,000,000 shares new class B common stock at $10 par value	90,000,000
10,000,000 shares outstanding capital stock	$100,000,000

The principal difference between common stock and new class B common is that the latter had no voting power and was not considered under the company's plan providing for participation by officers and employees in certain profits of the company. There was no authorization during the taxable year by charter amendment whereby the authorized number, class, or par value of petitioner's shares of stock was increased or decreased.

In 1912 the petitioner was young in the tobacco industry, being a very small corporation whose stock was owned by one family until other stockholders were brought in from time to time. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. Under the by-laws of the company, the holders of the only stock then outstanding were entitled to a special distribution each year based on the profits realized, and as a result the owners of this class of stock retained their holdings in order to participate in the profits.

At 1912 petitioner was in vigorous competition with three other tobacco companies, each having many times the capital of petitioner. After 1912 petitioner's growth was rapid. Its business prospered to such an extent that maintaining the capitalization of the company at a point where it could support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. At the same time the management of the petitioner desired to preserve (1) the reputation of the company, (2) the reputation of the stock, and (3) the behavior of the stock on the market, including its behavior in comparison with other similar stocks.

24 In 1918 the petitioner created the class B common stock which did not participate in the special distribution based on

the company's profits, and which was, therefore, available on the open market. Later this class B stock was eliminated by charter amendment in April 1926.

In July 1918, R. J. Reynolds, petitioner's largest stockholder, died. It became necessary for his estate to sell a substantial portion of the stock in order to pay the inheritance taxes on his estate. The stockholders of the petitioner were not large enough to absorb the stock sold by the founder's estate. This stock was purchased by several individuals, but subsequently, and prior to 1921, it was finally concentrated in the single ownership of United Retail Stores, which controlled United Cigar Stores, a large distributor of petitioner's tobacco products. United Retail Stores publicized the fact that it owned a substantial block of petitioner's stock. Rumors developed and the suspicion grew that United Retail Stores was dictating petitioner's business policies and was able to buy petitioner's tobacco products at lower prices and for better discount than other distributors and retailers. Furthermore, the dividends regularly paid by the petitioner made it possible for United Retail Stores to operate its approximately 2,000 retail stores without profit, and yet have a substantial amount with which to pay dividends to its own stockholders.

It was the judgment of petitioner's management that the reputation of the company, and the necessity of protecting its business required the purchase of this United Retail Stores' stock. Petitioner had recognized in 1918 the necessity of broadening its stockholding base, and the acquisition of this block of stock afforded petitioner an opportunity to remove a harmful situation and at the same time permitted petitioner to expand its stockholding list by feeding the stock back onto the market. The law department of the petitioner considered and ruled that petitioner was authorized to make the 1921 purchase, and the other purchases hereinafter related, and reissue the stock, although petitioner had no charter authority to deal in its own stocks.

For the reasons aforementioned the petitioner purchased during 1921 the block of old class B common stock held by United Retail Stores, the number of shares purchased being undisclosed. The purchase was made at a private sale, the stock in question not being listed on any exchange in 1921. The consideration paid was $607,200.96 in cash, which was slightly under the market price by reason of the amount of stock involved. As the result of subsequently effected stock split-ups and stock dividends, that portion of this purchase here involved came to represent 75,000 shares of new class B common stock, the certificates therefor being held by petitioner on January 31, 1929.

During all the years 1921 to 1929, inclusive, and thereafter, the petitioner followed the same general policy of availing itself of all opportunities that were presented for extending its stockholding base. The effectiveness of this general policy is revealed by the increase in the number of petitioner's stockholders over a period of years. In March 1922, when petitioner's stock was listed on the New York Stock

Exchange, petitioner had less than 2,000 stockholders, counting common stock and class B common stock. At the time of the market crash in 1929 there were 9,136 shareholders of B stock alone. In 1933 there were 41,000 stockholders and in April 1936 there were 52,000 holders of B stock.

In 1924 petitioner sold for cash 21,067 shares of the stock purchased in 1921 from United Retail Stores. The sales were made in the second and third quarters of 1924 on a rising market, following a substantial drop of the market in the first quarter.

In 1925 the petitioner sold for cash 11,000 shares of the stock purchased in 1921 from United Retail Stores. These shares were sold or reissued between February 10 and August 13, 1925. The management took advantage of a rising market to dispose of these shares without hurting its stock or the reputation of the petitioner.

By reason of a charter amendment in 1926, the management of petioner feared that speculators on the market might start a rumor that petitioner would declare a stock dividend. To protect the reputation of the stock, which included keeping it from jumping and precipitately dropping, the petitioner purchased through a broker for cash, 21,400 shares of its stock. After fear of the rumor had passed, the 21,400 shares were gradually fed back into the market.

In 1927 the petitioner's only transaction respecting its own stocks was the disposition of certain fractional shares accumulated in its hands in connection with the issuance of rights to subscribe or
26 receive additional stock. These fractional shares, which had cost petitioner nothing, were disposed of for cash in the amount of $240.83.

During April 1928, petitioner reduced the price of its cigarettes from $6.40 to $6 per thousand. Following this reduction the volume of petitioner's stock offered on the market was greatly multiplied. Petitioner, with a view to protecting the reputation of the stock of the company, its business and its brands, purchased for cash 43,300 shares of its stock, expecting thereby to protect the market against a precipitate fall in prices. After the market steadied the 43,300 shares were fed back into the market, together with 1,240 shares of the stock acquired from United Retail Stores in 1921.

During each of the aforesaid years 1924 to 1928, inclusive, the petitioner, R. J. Reynolds Tobacco Co., reissued solely for cash, certain shares of its new class B common stock, theretofore acquired solely for cash, in a manner similar to that hereinafter set forth with respect to the taxable year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive, and for no other purpose, it is agreed that, in executing its income tax return for each of such prior years, the petitioner noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus" and under subtitle (of said sched-

ule L) entitled "2. Non-taxable income * * * (f) Other Items of Non-Taxable Income (to be detailed)" under the notation "Profit R. J. R. Stock," or substantially similar notation, the following amounts:

Years	Amounts
1924	$999,335.25
1925	601,507.42
1926	85,003.70
1927	240.83
1928	1,271,023.19

At the close of 1928 petitioner had 30,000 shares of its new class B common stock, which became 75,000 shares by January 31, 1929, due to a 2½ for 1 split-up approved by the stockholders on Decem-
27 ber 28, 1928, thus reducing the par value of the stock from $25 per share to $10 per share.

Subsequent to January 31, 1929, the petitioner canceled certificates representing 15,000 shares of said 75,000 shares and issued in lieu thereof new certificates representing 15,000 shares of new class B common stock to divers persons who delivered to petitioner the sum of $708,690 in cash for said 15,000 shares. The 15,000 shares so disposed of by petitioner were acquired as a part of petitioner's 1921 purchase at a cost to petitioner of $121,440.19 in cash.

On December 18, 1929, 2,106,139 shares, or more than 23 percent of the total outstanding 9,000,000 shares of petitioner's new class B common stock, were in the hands of brokers, subject to trading or speculation. This stock was in a position to do great injury to petitioner, its stock, and its products. Approximately 2,000 employes of petitioner held shares of its stock and many of them had borrowed heavily on their stock. With the then market price of approximately 64, a heavy drop in the market would have been disastrous to many of petitioner's employees.

At the time of the market break in 1929 petitioner had $29,000,000 in cash and Government securities, which the management determined to and did use in purchasing the petitioner's stock offered on the market during the break in October and November 1929. During the height of the stock market panic, from approximately October 29 to November 13, 1929, petitioner held the market price of its stock at 50, purchasing 90 per cent of its stock offered on the market. As the panic eased, petitioner's purchases were scaled down to 40 and 39. During the taxable year 1929 petitioner purchased a total of 574,880 shares of its own stock.

In addition to selling the 15,000 shares aforementioned during 1929, petitioner sold 194,000 other shares of the new class B common stock it had purchased in 1929. One block representing 94,500 shares of new class B common stock was acquired by petitioner for cash in the amount of $4,908,966.17. Later in 1929 petitioner canceled the certificates representing these 94,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for $4,506,497 in cash. Another block of 99,500 shares of new class B common stock

was acquired by petitioner in 1929 for $4,601,807.43 in cash.
28 Later in 1929 petitioner canceled the certificates representing these 99,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for $4,703,608 in cash. The transactions covering the said 94,500 and 99,500 share blocks of stock were handled by brokers on the New York Stock Exchange.

At all times during 1929 the stock books and records of the petitioner indicated that the number of its new class B common stock issued and outstanding was 9,000,000 shares. From the time of acquisition of the certificates representing shares of petitioner's stock until the time of their cancellation and the issuance of new certificates in lieu thereof, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of petitioner under the entry "Investments in Non-competitive Companies," in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of petitioner as either increasing or reducing the number of the outstanding shares of its capital stock. At the times of the acquisitions by petitioner of certificates representing its capital stock, as set forth hereinabove, the cash of petitioner was reduced by the amounts of cash expended for their acquisition. Likewise, at the times in 1929 when the said certificates were disposed of, the cash of petitioner was increased by the amounts received from the disposition thereof.

At the close of the taxable year the petitioner had on hand 431,925 shares of its new class B common stock. As of December 31, 1929, these shares represented $19,270,690.98 out of the $19,601,594.77 total appearing on petitioner's books in the amount designated "Investments in Non-competitive Companies." The balance of the account represented investments in the stock of two small licorice companies (from which petitioner secured its supplies of licorice) and stock in the Glenn Tobacco Co. None of the shares of stock of the last mentioned three companies was for sale or was traded in by petitioner.

The profit from the sale by petitioner of its own shares of stock arose solely through the sale of new class B common stock. The stock certificates covering the shares sold in 1929 were endorsed, surrendered,
canceled, and reissued in the same normal manner as sales and
29 purchases of all of petitioner's shares of stock. Each transaction involved herein was a completed and closed transaction in the taxable year 1929. During 1929 each and every acquisition and each and every sale made by petitioner of its own stock was for cash and in no instance for anything except cash.

Petitioner's 1929 income tax return, schedule L, indicates a nontaxable profit of $436,581.21. It is stipulated that the last mentioned figure should be reduced by a $150,000 dividend to $286,581.21. The $436,581.21 item is reflected in petitioner's books as a cash item. The item went into petitioner's surplus account and was included in the

financial statement of the company made to its stockholders. It was carried as a nontaxable item in accordance with petitioner's understanding of what it was and because of Treasury Department regulations.

In his examination and audit for the year 1929, the respondent has not heretofore included as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited.

The parties stiuplated with respect to the original deficiency as follows:

14. It is the intent and desire of the parties here to dispose of (by agreement with the approval of the Board of Tax Appeals), all of the issues presented in the petition filed herein on May 4, 1933. In the deficiency letter dated April 2, 1933, from which this appeal was taken, the Commissioner determined that the petitioner realized a taxable profit for 1929 of $145,475.44 from the liquidation of the Tobacco Foil Company, Richmond, Virginia, and/or Winston-Salem, North Carolina. It is hereby stipulated and agreed that, for the purpose of this appeal, such profit should be reduced to $71,196.64. It is further agreed that the net taxable income for 1929, in the amount of $38.497,056.05, as determined by the Commissioner (in the said deficiency letter) should be reduced by $74,278.80—being the difference between $145,475.44 and $71,196.64, above mentioned; the tax should be recomputed accordingly.

15. By reason of the addition to taxpayer's net taxable income of the amount of $71,196.64, as set out in paragraph 14 hereinabove, the taxpayer's income tax due thereon to the State of North Carolina amounts to $2,774.13, and the similar in'ome tax to the State of Virginia amounts to $16.61, both of which said amounts properly constitute deductions in computing the net taxable income of this taxpayer for purposes of Federal income tax. It is, therefore, stipulated that in the final computation of deficiency in the instant cause, the said amounts of $2,774.31 and $16.61 should be allowed as additional deductions from income of this taxpayer; the tax should be recomputed accordingly.

OPINION

VAN FOSSAN: The sole issue in this case is whether petitioner by purchasing shares of its own stock, for cash, and later canceling the certificates and selling and issuing new certificates representing such shares for cash, realized a taxable gain. The amount of gain, the acquisitions and dispositions by petitioner of its own stock, the cost and sale prices thereof, and all other material facts are undisputed. There is only the question of law, whether the profit on the several transactions, $436,581.21, is taxable income. By stipulation of the parties this sum is reduced to $286,581.21 because of a $150,000 dividend.

At the time petitioner's tax return was made the regulations of the Treasury Department, article 66, Regulations 74,[1] provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock." Petitioner's return conformed to the regulations then in force, as it reported therein nontaxable income of $436,581.21 under the notation "Profit R. J. R. Stock." This was in accord with the manner in which petitioner had reported similar transactions for the years 1924 to 1928, inclusive, as hereinabove set forth.

31 Under date of May 2, 1934, article 66, Regulations 74, together with article 543, Regulations 65 and 69, and article 66, Regulations 77, being the regulations under the Revenue Acts of 1924, 1926, 1928, and 1932, was amended by Treasury Decision 4430.[2] Following this amendment of his regulations, respondent determined that the petitioner herein realized a net taxable profit from "trafficking" in its own stock in 1929. His determination gives effect to the losses sustained on some transactions and to the profits realized on others. By this amended answer respondent asks that petitioner's tax liability for 1929 be increased accordingly.

In his brief respondent admits that T. D. 4430 changes a long standing departmental construction, and he concedes it to be a well established rule of law that long continued executive construction contained in regulations must be deemed to have received legislative approval by the reenactment by Congress of the same statutory provision without substantial change. However, he asserts that this rule is to be applied only when it "does no violence to the letter or spirit of the provisions construed," Brewster vs. Gage, 280 U. S. 327, 336, and where the regulation operates to create a rule out of harmony with the statute, the regulation is a mere nullity, Manhattan General Equipment Co. vs. Commissioner, 297 U. S. 129, affirming 29 B. T. A. 395; Lynch vs. Tilden Produce Co., 265 U. S. 315; Miller vs. United States, 294 U. S. 435, and cases cited at page 440; Schafer vs. Helvering, 83

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[1] ART. 66. Sale by corporation of its capital stock.—The proceeds from the original sale by a corporation of its shares of capital stock whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount in not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

[2] Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon the original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Fed. (2d) 317. He submits that the amended regulation is a reasonable interpretation of the Congressional intent expressed in the statute.

32 The statutory provisions which the original regulation, article 66, Regulations 74, and the amendment thereto, T. D. 4430, supra, interpret are contained in section 22 of the Revenue Act of 1928, wherein the Congress defines "gross income."[3] As pointed out by counsel for petitioner in their brief, the interpretation and administration of this section of the statute in like or similar situations to that here obtaining have been uniform under all revenue acts, with the possible exceptions hereinafter noted, until the promulgation of respondent's T. D. 4430 on May 2, 1934.

This uniformity of construction and administration of the statute is one of the two principal arguments upon which petitioner rests its case. With great care petitioner's brief dovetails the regulations, rulings, and decisions of the Commissioner, the decisions of this Board, and the decisions of the courts, with the passage of the several revenue acts, in order to show the repeated reenactment of the definition of "gross income" after such regulations, rulings, and decisions were promulgated or made. Petitioner submits that over this period of approximately 21 years the repeated reenactment of the definition without change, modification, or amendment constitutes legislative approval and adoption of the departmental interpretation. Our attention is particularly directed, inter alia, to the decisions of the Supreme Court in Old Colony Railroad Co. vs. Commissioner, 284 U. S. 552; Helvering vs. Bliss, 293 U. S. 144; Old Mission Portland Cement Co. vs. Helvering, 293 U. S. 289; McFeeley vs. Helvering, 296 U. S. 102, and Koshland vs. Helvering, 298 U. S. 441.

These decisions, and the others considered, establish the rule that great weight should be given "to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change * * * (citing cases)." In addition, these de-

33 cisions establish the rule that where a statute "uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts." And finally these decisions establish that "the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement," Koshland vs. Helvering, supra. It is this latter rule which petitioner desires to invoke in this proceeding.

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[3] SEC. 22. GROSS INCOME.

(a) General definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

However, there is another rule of equal importance which the Supreme Court has stated and restated many times. This rule is to the effect that if the departmental construction is obviously or clearly wrong, the Court will so hold, regardless of the long continued practice in administering the act. United States v. Graham, 110 U. S. 219; Wisconsin Central Railroad Co. vs. United States, 164 U. S. 190; Manhattan General Equipment Co. vs. Commissioner, supra; Koshland vs. Helvering, supra. The Supreme Court has variously stated the rule, always to the same effect, that long continued departmental construction "* * *, is not to be overturned unless clearly wrong, or unless a different construction is plainly required," United States vs. Jackson, 280 U. S. 183, 193; "* * * will not be disturbed except for weighty reasons," Brewster vs. Gage, 280 U. S. 327, 336; "* * * ought not to be disturbed now unless it be plainly wrong," Universal Battery Co. vs. United States, 281 U. S. 580, 583; "* * * will not be overruled except for weighty reasons," Fawcus Machine Co. vs. United States, 282 U. S. 375, 378; "* * * will not be judicially disturbed except for reasons of weight * * *," McCaughn vs. Hershey Chocolate Co., 283 U. S. 488, 492.

These decisions, and others of similar tenor, expressly point out that circumstances may arise where the Court will refuse to follow the departmental construction, even though long continued and followed by subsequent reenactments by the Congress of the statutory section in question. In two recent decisions, Manhattan General Equipment Co. vs. Commissioner, supra, and Koshland vs. Helvering, supra, the Supreme Court repudiated the departmental construction. In the Manhattan case the original regulation was amended, as it has been here, and the question turned, as here, upon "whether the
34 loss (or gain) was to be determined in accordance with the original or the amended regulation." The Court held that the amended regulation correctly expressed the will of Congress. In the Koshland case the regulations had continued to the same effect, even after repeated decisions by the Supreme Court indicated their error, with the result that when the question was finally presented to the Court it expressly and decisively overruled the departmental construction.

As already stated, the situation here with respect to the original and amended regulations is analagous to the situation in Manhattan General Equipment Co., supra. There the Court stated that "not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. International Railway Co. vs. Davidson, 257 U. S. 506, 514." So here we must determine whether the amended regulation is consistent with the statute and whether it is reasonable.

Briefly summarizing the facts, it appears that petitioner acquired on the open market during the taxable year 574,880 shares of its own stock, for which it paid cash. During the taxable year it sold 209,000 shares of its own stock for cash. The excess of the sums received over the sums paid out in the various transactions in its own stock amounted to $436,581.21.

Considering the magnitude and extent of petitioner's operations during the taxable year, it could hardly be denied that it was dealing "in its own shares as it might in the shares of another corporation." T. D. 4430, supra. There were trades between opposing parties in a large number of transactions negotiated through brokers. The stock was not retired. If petitioner's transactions had been in the shares of stock of another corporation, no one would be so bold as to deny that it realized a net taxable gain therefrom. But petitioner says that since the transactions were in its own stock, no gain or loss resulted, because of the capital nature of each transaction. Simmons & Hammond Manufacturing Co., 1 B. T. A. 803; Hutchins Lumber & Storage Co., 4 B. T. A. 705; Union Trust Co. of New Jersey, 12 B. T. A. 688; J. H. Johnson, 19 B. T. A. 840; affd., Johnson vs. Commissioner, 56 Fed. (2d) 58; certiorari denied, Johnson vs. Burnet, 286 U. S. 551; Houston Brothers Co., 21 B. T. A. 804; Jewel Tea Co. vs. United States, 15 Fed. Supp. 56.

35 In Houston Brothers Co., supra, the Board fully considered and carefully reviewed its prior decisions on this question, overruled its decisions in Behlow Estate Co., 12 B. T. A. 1365, and New Jersey Porcelain Co., 15 B. T. A. 1059, cases in which gain or loss was recognized in transactions involving the taxpayers' own shares of stock, and reaffirmed the principle announced in Simmons & Hammond Manufacturing Co., supra. It is unnecessary again to cover this ground, particularly in view of the trend of decisions since Houston Brothers Co.

In S. A. Woods Machine Co., 21 B. T. A. 818, the Board considered the same general principle and rested its decision, in part, at least, upon the determination in the Houston Brothers Co. case. Upon appeal, Commissioner vs. Woods Machine Co., 57 Fed. (2d) 635 (C. C. A., 1st cir.), certiorari denied, 287 U. S. 613, the Circuit Court of Appeals reversed the Board. In the Woods case the corporate taxpayer received shares of its own stock in settlement of a patent infringement suit. The corporation retired the capital stock so received, but nevertheless the court held that taxable gain resulted. In determining the issue the court considered the statutory definition of "gross income" and the regulation interpreting the definition, section 213, Revenue Act of 1924, and article 543, Regulations 65, which are to all intents and purposes the same as section 22, Revenue Act of 1928, and article 66, Regulations 74. In the course of its opinion the court stated:

Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved. Walville Lumber Co. vs. Com. of Internal Revenue (C. C. A.), 35 F. (2d) 445; Spear & Co. vs. Heiner (D. C.), 54 F. (2d) 134. If it was in fact a capital transaction, i. e., if the shares were acquired or parted with in connection with a readjustment of the capital structure of the corporation, the Board rule applies. Doyle vs. Mitchell Bros. Co., 247 U. S. 179, 184, 38 S. Ct. 467, 62 L. Ed. 1054; Eisner vs. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. But where the transaction is not of

that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in com-
36 puting the taxable income. The view taken by the Board of Tax Appeals (see Houston Brothers Co. vs. Commissioner, 21 B. T. A. 804) presses accounting theory too far in disregard of plain facts. It is not supported by any decision which has come to our attention except those of the Board. In Knickerbocker Imp. Co. vs. Board of Assessors, 74 N. J. Law 583, 585, 65 A. 913, 915, 7 L. R. A. (N. S.) 885, the plaintiff corporation was held liable for the franchise tax on its own stock which it had bought and held in the treasury. The court said: "Stock once issued is and remains outstanding until retired and canceled by the method provided by statute for the retirement and cancellation of capital stock." (Dill, J.) In United States vs. Kirby Lumber Co., 284 U. S. 1, 52 S. Ct. 4, 76 L. Ed. ——, dealing with a question somewhat similar to the present one, the court said: "we see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here." (Holmes, J.) See, too, Maryland Casualty Co. vs. United States, 251 U. S. 342, 40 S. Ct. 155, 64 L. Ed. 297. As has often been said, taxes are practical things and should be dealt with on a practical basis.

To the same effect are Allyne-Zerk Co. vs. Commissioner, 83 Fed. (2d) 525 (C. C. A., 6th Cir.), affirming 29 B. T. A. 1194; Dorsey Co. vs. Commissioner, 76 Fed. (2d) 339 (C. C. A., 5th Cir.), affirming memorandum opinion of this Board; certiorari denied, 296 U. S. 589.

In the last mentioned case the court specifically considered the last sentence of article 66, Regulations 74, supra, and the amendment thereto, T. D. 4430. In its opinion the court states:

The point of law dealt with by the Board is whether the transaction was controlled by the last sentence of Regulations 74, Art. 66: "A corporation realizes no gain or loss from the purchase or sale of its own stock." A reading of the whole Regulations, which had existed at least since 1918, shows that it referred mainly to the original sale of the capital stock and to stock turned back by stockholders to be resold to raise more capital. It was amended in 1934 by T. D. 4430 to distinguish clearly between original capital transactions and
37 ordinary commercial dealings in its own stock as in that of another corporation. It may well be that a corporation taking its cash and buying its own stock makes neither gain nor loss by the mere purchase. That is true of any purchase for cash. But when in a business exchange for its real estate it receives in part its own stock it is converting by sale a previous purchase, and if what it receives has a fair market value the gain or loss realized in the exchange must be measured and taxed. It is not the purchase of the stock but the sale of the real estate that is regarded.

The petitioner contends that the S. A. Woods Machine Co. reversal in no wise involved or turned upon the principle of Simmons & Ham-

mond Manufacturing Co., which, it is asserted, is the present rule of the Board. It is so urged, despite the reversals of Board decisions in Schiller Piano Co., 23 B. T. A. 376; reversed on confession of error by Commissioner, Schiller Piano Co. vs. Commissioner, 58 Fed. (2d) 1085; Boca Ceiga Development Co., 25 B. T. A. 941; reserved, Commissioner vs. Boca Ceiga Development Co., 66 Fed. (2d) 1004; and despite the decisions of the Board in Houghton & Dutton Co., 26 B. T. A. 52; James D. Robinson, 27 B. T. A. 1018; affd., Robinson v. Commissioner, 67 Fed. (2d) 972; Niagara Share Corporation, 30 B. T. A. 668.

While no one of the foregoing decisions specifically overruled the doctrine of Simmons & Hammond Manufacturing Co., supra, the decisions are at variance with the principle of the latter case. Indirectly, if not directly, Simmons & Hammond Manufacturing Co. has been overruled. In the Houston Brothers Co. case the Board stated, after its review of the authorities: "The foregoing considerations, in our opinion, demonstrate the soundness and wisdom of the rule of the regulations and of the Simmons & Hammond case. When a corporation engages in a transaction which involves the receipt or disposition of its own shares, no gain or loss is recognizable in determining its taxable income." The Houston case was not appealed, but the principle upon which it was decided was expressly repudiated by the court in Commissioner vs. Woods Machine Co., supra, wherein it is stated that the Houston decision "presses accounting theory too far in disregard of plain facts."

An examination of the Simmons & Hammond manufacturing
38 Co. case, supra, reveals certain facts analogous to those in this proceeding. There the corporate taxpayer purchased 94 of the 323 shares of its own outstanding stock from four stockholders. It paid three stockholders $6,800 cash for 34 shares and paid one stockholder $8,697.40 in cash and $5,449.61 in property of the company for 60 shares. During the same taxable year the corporation sold the 94 shares, purchased at a cost of $20,947.01, to its two principal stockholders, 47 shares each, for the sum of $10,340, and claimed a loss as a result thereof of $10,607.01. The Board refused to allow the loss, holding that the purchase and resale by the corporation of 94 shares of its own stock "constituted a capital transaction"; that by the purchase of its own stock the corporation sustained no loss; that the resale of the stock resulted in no loss to the corporation; and that the method used by the corporate taxpayer "was in truth and in fact a distribution of surplus" to its two principal stockholders, Simmons and Hammond.

Under the facts in this proceeding we are unable to see how it could be said that petitioner's purchases and sales of its own stock were, in truth and in fact, distributions of its surplus. The various transactions in its own stock were directed toward remedying a harmful situation among the retailers of its products, toward protecting its employees, its trade brands, and its business, and in pursuance of a long established policy of widening its stockholding base. We have found no evidence in this record indicating that distribution of the corpora-

tion's surplus was the objective of these transactions. The fact is that petitioner's cash was reduced with each purchase and increased after each sale by the proceeds thereof, and that during the interval between purchase and sale the shares appeared in an account designated "Investments in Non-competitive companies."

As above noted, the record establishes that the primary purposes of the corporation in buying and selling its own stocks were to get wider stock ownership and to support the market, both normal business motives frequently employed. Albeit there is no testimony that the immediate profit motive was present, the reader of this record would be naive indeed who would not observe such a motive interlarded in the entire situation. The instant tax year does not present an isolated instance. It presents merely the current result of a practice extending over a period of several years.

39 Another contention upon which petitioner rests its case is that a corporation's own stock is not "property" or "assets" in its own hands, citing People vs. Kelsey, 93 N. Y. S. 369; Stevens vs. Olus Manufacturing Co., 130 N. Y. S. 22; Borg v. International Silver Co., 11 Fed. (2d) 147. We find little of assistance in these cases. One phrase from the Borg case is noteworthy, however, and that is where the court, in making its pronouncement of its conclusion, states: "It makes no difference whether this satisfies ideal accounting or not." We are not concerned with the bookkeeping entries that would be required to record the transactions in petitioner's own stock, nor is it material to our purposes whether the increment of gain be denominated "contingent profits" or be called by some other name.

The courts of the various states have established by an overwhelming weight of authority that a solvent corporation can purchase and hold its own shares of stock, and the question of whether it holds the purchased stock as an asset is largely a matter of intent. Pabst vs. Goodrich, 133 Wis. 42; 113 N. W. 398, and cases cited; Draper vs. Blackwell & Keith, 138 Ala. 182; 35 So. 110; City Bank vs. Bruce, 17 N. Y. 507; Johnson County vs. Thayer, 94 U. S. 631; Adam vs. New England Inv. Co., 33 R. I. 193; 80 Atl. 426; Scriggins vs. Dalby Co. (Mass., 1935), 195 N. E. 749; San Antonio Hardware Co. vs. Sanger (Texas), 151 S. W. 1104; see also note in 61 L. R. A. 621 and discussion of Leland vs. Hayden, 102 Mass. 542, appearing at page 623; Cook on Corporations, §§311, 313; 7 R. C. L. 551, "property" includes corporation's own stock; and 7 R. C. L. 552 regarding corporate intent.

This petitioner held its shares in its treasury with the unquestioned intention of selling and reissuing them, preferably by placing the stock in the hands of permanent investors. The technical status of the stock while in its hands concerns us little.

Petitioner advances as a further argument in opposition to taxing the gain resulting from petitioner's transactions that the purchases and the sales were capital transactions which affected the corporation's capital structure. This argument is fully met by the pro-

visions of the amendment to the regulations. So far as transactions, capital in their nature, are concerned, T. D. 4430, supra, expressly and correctly excludes them from classification as taxable
40 transactions. It seeks to reach only those transactions which are actually and in truth ordinary commercial dealings by a corporation in its own stock. The fallacy in petitioner's position is that its dealings in its own stock do not fall within the category of capital transactions.

To hold the contrary and sustain petitioner's position that no taxable profit accrues when a corporation, with no proven purpose of effecting changes in its capital structure, goes into the market and buys its own stock, places and holds the same in its investment account and then, a favorable opportunity presenting itself, sells the same through the market at a higher price than it paid for the same, would require us to engage in the exploration of the metaphysical concepts of accounting far beyond the realm of practical legal reasoning. It "presses accounting theory too far in disregard of plain facts."

We have observed that the Supreme Court has held that a regulation or administrative practice which has been long followed and has received legislative sanction should not be overturned except for weighty reasons. That such regulation or practice is based on a false premise; that it elevates to a position of authority a concept which runs counter both to reason and ordinary business judgment; that it prefers a highly artificial interpretation to the usual rationale of normal minds would seem to be "weighty reasons" for dethroning such a regulation or practice.

In our opinion the regulation, as amended, is reasonable, and is consistent with the statute. The prior regulations do not meet these tests. Therefore, the respondent's determination is approved.

In so far as Simmons & Hammond Manufacturing Co., supra, and cases following it conflict with this decision, they are hereby overruled.

If, as a result of our decision herein, petitioner's taxes to the States of Virginia and North Carolina are thereby increased, provision should be made for proportionately increasing petitioner's allowable deductions.

Reviewed by the Board.

Decision will be entered under Rule 50.

MORRIS, MURDOCK and LEECH dissent.

ARUNDELL and TURNER did not participate in the consideration of or decision in this report.

41 Before United States Board of Tax Appeals

[Title omitted.]

Decision

Pursuant to opinion of the Board promulgated April 27, 1937, the respondent in the above entitled proceeding filed notice of settlement

on June 17, 1937. The case was called for settlement on July 14, 1937, at which time no objection was offered to the respondent's proposed recomputation of the tax. It is therefore

Ordered and decided: That there is a deficiency in income tax for the year 1929 in the amount of $37,865.62.

(s) EUGENE BLACK,
Chairman.

Enter:
Entered July 16, 1937.

In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Petition for review

Filed October 12, 1937

To the Honorable, the Judges of the United States Court of Appeals for the Fourth Circuit:

R. J. Reynolds Tobacco Company, the petitioner, in
42 support of this, its petition, filed pursuant to the provisions of sec. 1001 of the Act of Congress entitled the Revenue Act of 1926 (as amended by sec. 1001 of the Revenue Act of 1932), for the review of the decision of the Board of Tax Appeals, rendered on the 16th day of July, 1937, determining and ordering deficiencies in income tax of petitioner for the calendar year 1929, in the amount of $37,865.65; and shows to the Court as follows:

I

The Commissioner determined a deficiency in income tax in the amount of $15,990.65 for the calendar year 1929, and on April 3, 1933, he mailed to petitioner a Notice of Deficiency in the same amount.

In his said Notice of Deficiency the Commissioner advised the taxpayer that the said deficiency was based upon his determination that the taxpayer had realized a profit of $145,475.44 from the acquisition and subsequent liquidation of a corporation known as Tobacco Foil Products Company.

On May 4, 1933, petitioner filed an appeal from the said Notice of Deficiency, in the Board of Tax Appeals.

Thereafter petitioner and respondent agreed and stipulated that the Commissioner's determination of profit (of $145,475.44) on the above mentioned transaction was erroneous to the extent of $74,278.89, and that the correct profit to be added to gross income was $71,196.64.

On February 13, 1936, respondent filed an "Amended Answer" in this cause, and therein pleaded and raised a new and affirmative issue, not theretofore appearing in this cause. The new issue thus presented herein was based upon such subsequent determination of the Commissioner that petitioner had realized taxable profits and taxable

income by reason of certain acquisitions of its own common capital stock for cash, and the subsequent re-issue of a portion thereof in 1929, for cash. The facts surrounding the said transactions are set out infra herein.

On March 14, 1936, petitioner filed Reply to respondent's Amended Answer and denied that it had realized taxable profits or income upon any of said transactions and in bar of respondent's claim pleaded the Regulations of the Treasury Department; the opinions, rulings,
43 decisions and determinations of the Commisisoner, the Secretary of the Treasury and the General Counsel; the opinions, decisions, order and judgments of the Board of Tax Appeals, and of various courts and tribunals which specifically ruled and held that a corporation did not realize a taxable profit nor sustain a deductible loss solely upon the acquisition by it of shares of its own stock or upon the issuance or disposal by it to others of such shares of its own stock.

The cause came on for hearing in the Board on April 27, 1936, at which hearing petitioner and respondent filed a stipulation of certain material facts, and at which hearing competent and material evidence in the form of the testimony of Mr. S. Clay Williams, former president and now Chairman of the Board, of petitioner, was submitted.

Thereafter, on April 27, 1937, the Board promulgated an opinion decision, and findings of fact in the said cause. Three members of the Board dissented and two did not participate. Therein the Board decided that petitioner's transactions in the year 1929, by which it reissued for cash its own common stock, theretofore acquired by it for cash, were taxable transactions from which a taxable profit or income resulted in the amount of $286,581.21.

On July 16, 1937, the Board entered a decision ordering that there is a deficiency in income tax for the year 1929 in the amount of $37,865.62.

II

The nature of the controversy is as follows:

For many years, and since the inauguration of the income tax, the Secretary of the Treasury, the Commissioner of Internal Revenue, and the General Counsel of said Bureau, had ruled, decided, and held that if a "corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation" and that "a corporation realizes no gain or loss from the purchase or sale of its own stock." Regulations so construing the taxing statutes were promulgated by the
44 Treasury Department under early revenue acts. Each successive revenue act was enacted in light of such construction, and each revenue act was followed by regulations placing the same construction upon it. This continued for approximately 21 years and during that time some seven or eight revenue acts had been enacted and appropriate regulations promulgated pursuant to each of them; and during

said period the Treasury Department had periodically and consistently issued rulings and decisions in support of such regulations. Likewise, during such time the Treasury Department had continuously applied this doctrine in income tax cases arising under the various revenue acts. While the number of such decided cases cannot be now definitely known, their number was, without doubt, many thousands. When the Board of Tax Appeals was organized this issue was early presented to it, and the Board affirmed the correctness of the said Treasury ruling in a large number of decided and published cases. In light of such Board decisions and opinions, at least four of said revenue acts became law, and identical regulations and rulings were duly promulgated pursuant thereto. These rulings, decisions, opinions, and regulations (of the Treasury, the Bureau, and the Board) were applied uniformly and consistently, and the rule and doctrine thereby established was well known and recognized and became as well recognized, established, and settled as legislative history, uniformity of practice, and long and consistent application can make it. The law, the regulations, the rulings, decisions, and opinions stood in this wise in the year 1929 (under the Revenue Act of 1928) and for about 6 or 7 years thereafter, during which subsequent period two further revenue acts were enacted without change, and identical regulations and rulings were promulgated under them.

In the year 1929 the transactions in question here occurred.

In the year 1934 the Department issued a Treasury Decision (T. D. 4430) purporting to change existing Regulations. This ruling was incorporated into Regulations 86, which were promulgated in the year 1935. The Commissioner construed said Treasury Decision in its application to the 1929 transactions of this petitioner, so as to overturn the long continued doctrine and rule above outlined, and so as to hold taxable a transaction in which this petitioner acq-
45 certain of its common capital stock for cash and which it held as treasury stock for varying periods as long as 8 years and, after cancelling the same, re-issued such stock for cash to divers persons who, upon such acquisition, became stockholders of the company. To apply to petitioner's transactions in 1929, the said Treasury Decision was applied retroactively over a period of approximately 12 years. The circumstances were as follows:

Petitioner is a New Jersey corporation with principal office and place of business in Winston-Salem, N. C. Its income tax return for 1929 was filed with the Collector of Internal Revenue for the District of North Carolina. Petitioner is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco, and cigarettes. Its only outstanding stock was common stock. Its capitalization was as follows:

1,000,000 sh. Common Stock (sometimes referred to as Class A common stock) at $10 par value	$10,000,000
9,000,000 sh. New Class B Common Stock at $10 par value	90,000,000
10,000,000 sh. common stock	$100,000,000

The difference between these two classes of common stock (Common Stock and New Class B Common Stock) is that the latter had no voting power, while the former had voting power and participation in certain profits of the company when held by officers and employees of the company.

In 1912 the petitioner was young in the tobacco industry, being a relatively small corporation with only a small number of stockholders. As late as 1922 there were less than 2,000 stockholders of both classes of stock. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. At 1912 petitioner was in vigorous competition with three other tobacco companies, each having many times the capital of petitioner. After 1912 its growth was rapid. Its business prospered to such an extent that maintaining
the capitalization of the company at a point where it could
46 support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. Petitioner had come to the realization that it was of the greatest importance that the reputation of the company and of its stock be preserved and that such reputation would depend to a great extent on the behavior of the stock in the market, including its behavior in comparison with other similar stocks, and upon a wider spread of its stockholding base. The confirmation of this realization was not long deferred.

In July, 1918, R. J. Reynolds died. He was petitioner's largest stockholder. It was necessary for his estate to sell a substantial portion of petitioner stock in order to pay taxes on his estate. The stockholders of the company were comparatively few and were not enough to absorb the stock that had to be sold by the founder's estate. Not long afterwards this stock came into the hands of United Retail Stores, which controlled United Cigar Stores Co., a large distributor of petitioner's products. False rumors developed and the suspicion grew that United Retail Stores was dictating petitioner's business policies and was able to buy petitioner's products at lower prices and for better discounts than other distributors and retailers. Besides, the dividends paid by petitioner made it possible for United Retail Stores to operate its large chain of retail stores (about 2,000 in number) without any profit and yet be able to pay dividends to its own stockholders on its own stock.

This was a source of embarrassment and peril to petitioner, and it was realized that the reputation of the company and the necessity of protecting its business and its assets required that this stock be acquired from United Retail Stores. As stated above, petitioner had realized the danger to it of its small stockholders' base and this danger was brought home to it when Mr. Reynolds died and a large block of petitioner's stock had to be sold by his estate, and a further danger became apparent when that large block of stock became centralized in United Retail Stores, as above recited. Petitioner realized that it was of the highest importance to broaden its stockholding base, and the acquisition of the large block of stock from

United Retail Stores would afford it the opportunity to remove a dangerous and harmful situation, and at the same time to
47 expand its stockholders' list by causing that stock to be distributed widely among the public.

For the above reasons petitioner began negotiations for the acquisition of the said stock, and in 1921 acquired said stock for cash in the amount of $607,200.96. Thereafter, due to stock dividends and split-ups a portion of the stock acquired came to represent 75,000 share of new Class B Common Stock held by the company at January 31, 1929, which was about 8 years later.

In accordance with its determination to build up its stockholding base and save the company from further dangers such as had been averted, as aforesaid, petitioner from time to time re-issued the said stock to persons desiring to become stockholders of the company. This policy proved successful and effective in improving the company's stockholding base and the company availed itself of the opportunities thus presented for extending its stockholding base. The company considered this policy vital to its existence and success. The effectiveness of this policy is evidenced by the increase of petitioner's stockholders. In March 1922, when petitioner's stock was first listed on the Stock Exchange, petitioner had less than 2,000 stockholders (counting both common stock and Class B stock). By 1929 there had been an increase in stockholding base in Class B stock alone of more than 450%, there being 9,136 stockholders in that year of Class B stock alone. By 1933 there were 41,000 (an increase of over 2,000%) and in April 1936 there were 52,000 (an increase of over 2,600%) stockholders of B stock alone. As stated above, in January 1929 petitioner still held 75,000 shares of B stock, out of the 1921 acquisition from United Retail Stores, which it had not yet re-issued. The company had observed the sound policy of re-issuing this stock in such way as to protect and uphold the reputation of the company, its stock, its business, and its brands and trade marks.

But difficulties and dangers to the company again threatened from time to time. By reason of a proposed charter amendment in 1926, the management of petitioner anticipated that speculators in the market might start a false rumor that petitioner would declare a stock dividend. While such a rumor would have been false, yet petitioner feared that such speculators might injure the reputation of the company and its stock by causing the stock to jump precipitately
48 on the market and then fall precipitately when the rumor was proven to be untrue. In an attempt to prevent such an unwarranted fluctuation of the stock on the market based on such a false rumor, petitioner in 1926, prior to the call of the meeting looking to the proposed charter amendment changing its capital structure, acquired for cash 21,400 shares of its new Class B Common Stock. This action was taken as a precautionary measure to provide a cushion against such anticipated speculations in the market. After the proposed change in the company's capital structure had been effected and after the fear of said rumors had passed, the stock was gradually re-issued for cash upon demand for it by the public.

Still another danger faced the company in 1928. In that year it reduced the price of its cigarettes from $6.40 to $6 per thousand. This caused a heavy selling of petitioner's stock in the market and threatened to cause a serious break in the market for petitioner's stock. In order to avert this danger and to protect its reputation, its stock, its business, and its brands, the company acquired in the open market 43,300 shares of its own stock to prevent a precipitate fall in the market. When the market steadied this stock was gradually re-issued to the public upon demand therefor.

Between 1924 and 1928, inclusive, petitioner had re-issued to persons desiring to acquire Reynolds stock, various portions of the stock it had acquired in the transactions above recited. Such stock was always issued for cash and never in any transaction involving the sale of merchandise. Every such transaction was made under circumstances and in a manner similar to those in 1929, hereinafter outlined, and every such transaction in those years and in 1929 was made under similar circumstances and for reasons substantially similar to those above outlined. For each of the said years 1924 to 1928, inclusive, petitioner filed income-tax returns and set forth each such transaction and reported the results of each such transaction as non-taxable income, for the reasons that the regulations, rulings, and decisions of the Treasury Department and of the Board specifically held that the transactions were non-taxable under the law, and those regulations, rulings, and decisions specifically held that such transactions constituted adjustments to capital surplus and in no way affected the status of taxable income. The Commisisoner so treated each tax re-
49 turn of petitioner for each of such years, and, after examination and determination, closed the returns of petitioner on such basis.

At the close of 1928 petitioner had in its treasury 30,000 shares of its own stock which it had acquired under the circumstances and for the reasons hereinabove stated. On January 31, 1929, these 30,000 shares became 75,000 shares due to a 2½ for 1 split-up, which reduced the par value of the company's stock from $25 to $10 per share.

After this split-up the company continued as before to re-issue such shares upon public demand therefor. In every instance, both before and at this time, the stock certificates acquired by the company were cancelled and when the stock was re-issued it was represented and evidenced by new certificates issued by the company. The company so issued 15,000 shares of the 75,000 held by it on January 31, 1929, as set out in the last preceding paragraph.

Later in 1929 another grave danger threatened the company. The magnitude of this danger was greater than any of those previously recited. A very large number (2,106,139) of shares had been acquired by brokers, subject to trading or speculation. This was more than 23% of the outstanding shares of the company. When the collapse of the market took place this stock was in a position to do great injury to the petitioner, its stock, and its products. It constituted a serious

menace. Approximaely 2,000 employees of the company had shares of its stock and many of them had borrowed heavily on their stock. With the then market price of about 64, a precipitous drop in the market would have been disastrous to many of them and the situation was fraught with peril for the company. In line with its decisions in previous crises, the company determined to, and did, support the market for its stock during the break in October and November 1929, and during the height of the panic in that period it sustained the market price of its stock at 50. In order to accomplish this it was necessary for the company to take 90% of the amount of offerings of its own stock thrown on the market. If the company had refrained from protecting its stock in this way the market would have dropped precipitously and the company would have been in position to have bought its stock at a far less figure than 50. As the panic eased
50 petitioner attempted to withdraw its support from the market, with the result that its stock dropped to 40 and 39. For these reasons, and in this way only, the company acquired a large volume of shares of its own stock.

Like all the preceding transactions hereinabove recited in which it acquired such stock, the stock was acquired under circumstances of business duress and the reasons therefor in every case was to avert peril to the company, and for no other purpose. Likewise, in all instances the company used the opportunity to bring about a widening of its stockholding base and the widest possible spread of its stock among the public and to prevent the concentration of its stock in a few hands, with the grave dangers inherent therein to the company, its reputation, and its business. Accordingly the company, upon demand from the public therefor, issued new certificates representing such stock to the persons demanding and paying therefor. In this way the company acquired a great number of new shareholders and issued stock to them which it had acquired in the market panic of 1929, as well as other shares which it had acquired during the previous 8 years, as above set out.

In no instance was the company motivated by any aim or purpose other than herein set out. In no instance was there any margin trading. In no instance was the transaction entered into for the purpose of realizing a profit on its own stock. In no instance did the company trade or "traffic" in its own stock as that term is commonly used and understood. In every instance the transaction involved only common stock of the company. In every instance the stock and the certificate representing it was endorsed and surrendered to the company and cancelled by the company, and when it was re-issued a new certificate was prepared and delivered in the ordinary manner of the issuance of original shares of its capital stock to subscribers. Each and every acquisition and each and every re-issuance of stock by petitioner of its stock was for cash and in no instance for anything but cash.

During the tax year in question (1929) petitioner issued shares of its own common stock to the public and received therefor $286,581.21

more than the acquisition cost of such shares. This amount was reflected in petitioner's surplus account and was carried and treated as a non-taxable item in accordance with the Regulations
51 and Rulings of the Treasury Department in force and effect in the year 1929, and which had been in force and effect, unchanged, since the beginning of income tax regulations, and which remained in force and effect, unchanged, until 1935 (six years after the tax year in question).

In 1935 the Commissioner issued new regulations purporting to change existing regulations in a manner claimed by him to render the instant transactions taxable. By applying retroactively such purported amended regulations to every year not barred by statutory limitations, the Commissioner attempted to hold taxable the instant transaction. On that basis he held that the transactions herein recited were taxable, and asserted a deficiency by applying the corporate income tax rate to the above mentioned amount of $286,581.21.

Petitioner resisted the assertion of the deficiency on the grounds that upon sound and fundamental principles of law, economy and accounting, the said transactions were, and by their inherent nature had to be, adjustments to the capital structure of the company, and could no by their very nature be income transactions; that the recognition of this principle had by long continued and consistent practice and application become the law of this case; that repeated re-enactments by the Congress of revenue acts (including the Revenue Act of 1928) in light of and in recognition of the many years of continuous application of the principle, is an adoption by Congress of such construction in the re-enacted statute; that all "possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative history";* that such long continued interpretation and construction has the force and effect of law and may not be overturned unless it is so plainly wrong that there can be no doubt about it; that if there is a doubt it must be resolved in favor of such long continued recognition of the principle by the Commissioner and by the Congress; that if such doubt exists it must be resolved in favor of the taxpayer under the established doctrine that doubts generally must be so resolved; and further, in the instant case, if any doubt exists, it must be resolved in favor of the instant taxpayer because in this case the burden
52 is cast upon the respondent by operation of law, and respondent has the benefits of no presumptions or inferences as to the correctness of his ruling—for the reason that this is an affirmative issue raised belately by respondent's plea, as to which issue he must assume the burden of proof of correctness without the aid of the inferences or presumptions of correctness.

*McCaughn v. Hershey Chocolate Co., 283 U. S. 492, 75 L. ed. 1183, 1186–1187.

III

In its decision the Board of Tax Appeals made Findings of Fact and rendered an Opinion.

In its Findings of Fact the Board found and held the facts to be substantially as recited in paragraph II hereinabove.

In its Opinion the Board held that when in 1929 it reported as non-taxable the results of these transactions, petitioner complied with the Regulations, which provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock," and that this was in accord with the manner in which petitioner had reported similar transactions for 1924 to 1928, inclusive. The Board further held that Treasury Decision 4430 of May 2, 1934 (purporting to amend all regulations back as far as 1924), changed a long standing departmental regulation which had received long continued executive construction, and that during that time there had been repeated re-enactment of successive revenue acts without substantial change; and that the statutory provision defining "gross income" under which this case arises, is contained in sec. 22 of the Revenue Act of 1928, and that the interpretation and administration of that section, in situations like that obtaining in this case, have been uniform under all revenue acts until the promulgation of T. D. 4430, on May 2, 1934.

The Board, in its Opinion, than called attention to the authorities establishing the rule that a regulation, long and consistently followed, particularly when Congress has re-enacted the statute without change, is not to be overturned, since such re-enactment by Congress without change of a statute which has previously received long continued executive construction, is an adoption by Congress of such construction. The Board also pointed to what is termed "another rule" to the effect that if the departmental construction is
53 obviously or clearly or plainly wrong, the Court will so hold regardless of the long continued practice in administering the act, but that such construction will not be disturbed unless it is obviously, plainly, or clearly wrong.

The Board then concluded that "we must determine whether the amended regulation is consistent with the statute and whether it is reasonable."

The Board further concluded that: "Considering the magnitude and extent of petitioner's operations during the taxable year, it could hardly be denied that it was dealing 'in its own shares as it might in the shares of another corporation,'" and observed that if these transactions had been in the shares of another corporation, a taxable gain would have resulted.

The Board then reviewed a number of its previous decisions (beginning with Simmons & Hammond Mfg. Co., 1 B. T. A. 803), holding that where a corporation purchases and sells its own stock for cash no gain or loss results because of the capital nature of such trans-

actions; and then reviewed certain others of its decisions in which the Board applied a different rule to a different principle involved in transactions wherein a corporation realized a profit on the sale of commodities and accepted shares of its own stock as a medium of payment. The Board observed arguendo that, in Houston Brothers Co., 21 B. T. A. 804, it had referred to Simmons & Hammond Mfg. Co., supra, with approval; that in S. A. Woods Machine Co., 21 B. T. A. 818, the Board had rested its decision, in part at least, upon the Houston case; that in the S. A. Woods case the Board was reversed; that although the Houston case was not appealed, the decision therein was criticized by the Appellate Court in the S. A. Woods case; and that since the S. A. Woods case was reversed, the criticism of the Houston case was in effect a reversal of the Simmons & Hammond case, because the latter case had been cited with approval in the Houston case. From the foregoing the Board concluded that "while no one of the foregoing decisions specifically overruled the doctrine of Simmons & Hammond Manufacturing Co., supra, the decisions are at variance with the principle of the latter case," and that "indirectly, if not directly, Simmons & Hammond Manufacturing Co. has been overruled."

The Board proceeded then to find that in the instant case "the various transactions in its own stock were directed toward
54 remedying a harmful situation among retailers of its products, toward protecting its employees, its trade brands, and its business, and in pursuance of a long established policy of widening its stockholding base," and that "The record establishes that the primary purposes of the corporation in buying and selling its own stock were to get wider stock ownership and to support the market." The Board then concluded that "albeit there is no testimony that the immediate profit motive was present, the reader of this record would be naive indeed who would not observe such a motive interlarded in the entire situation," and concluded further that the question as to whether the stock in petitioner's hands constituted an "asset" which was bought and sold, is largely a matter of intent; and that since the petitioner held its shares in its treasury with the intent of re-issuing them, "the technical status of the stock while in its hands concerns us little."

The Board next concluded that petitioner's "dealings in its own stock do not fall within the category of capital transactions."

The Board finally concluded that the amended regulation is reasonable and consistent with the statute and that the previous long standing regulation was thereby overruled.

Upon the conclusions reached by it the Board held that the transaction in question gave rise to taxable income to petitioner, and accordingly on July 16, 1937, entered a decision and order saying that there is a deficiency in income tax for the year 1929, based upon such additional income.

II

Petitioner, being aggrieved by said findings of fact, opinion, and decision and order of the Board, and being a corporate taxpayer with

principal office and place of business in the City of Winston-Salem, North Carolina, desires a review thereof in accordance with the provisions of the Revenue Act of 1926 and 1932, and in accordance with other pertinent provisions of law, by the United States Circuit Court of Appeals for the Fourth Circuit, within which Circuit is located the principal office and place of business of the petitioner, and within which Circuit is located the office of the Collector of Internal Revenue to whom petitioner made its income tax returns for the year here under consideration.

55

V

Petitioner says that in the Decision, Opinion and Order of the Board manifest error occurred and intervened to the prejudice of the petitioner, and petitioner assigns the following errors, and each of them, which, it avers, occurred therein and upon which it relies to reverse the said Decision and Order so rendered and entered by the Board in this cause, to-wit:

1. The Board erred in concluding and deciding that the decision of the instant issue depends upon the determination whether the amended Regulation is reasonable and consistent with the statute.

2. The Board erred in concluding and deciding that if the amendment to the Regulations is reasonable and consistent with the statute, such amendment can overturn a regulation of many year's standing, in light of which long standing regulation, and in contemplation of the long continued uniform construction put upon it by the Department and the Board, Congress has repeatedly reenacted the taxing statutes without change.

3. The Board erred in failing and refusing to decide and hold that possible doubts as to the proper construction of the statutory language used should be resolved in the light of its administrative and legislative history.

4. The Board erred in failing and refusing to decide and hold that the legislative and administrative history of the section in question gave color and substance to the regulations, rulings, decisions and opinions of the Department and of the Board, covering a period of approximately 20 years, and that it erred in failing and refusing to construe the statute in light of such long continued administrative, judicial and legislative history.

5. The Board erred in concluding and deciding that the amended regulation is reasonable and consistent with the statute and for that reason that the long continued administrative, judicial and legislative history should be ignored and overturned, and this in face of repeated and numerous decisions of the Supreme Court to the contrary—such decisions having firmly established the

56 rule that: (1) such long continued construction shall not be overturned unless obviously, clearly and plainly wrong and totally contrary to law; (2) that if there be merely doubt as to the soundness of such long continued construction, that construction shall be respected and not overruled; and (3) that all possible doubts as to

the proper construction shall be resolved in the light of its administrative and legislative history.

6. The Board erred in failing to find and decide that Regulations 74 (under the 1928 Act) in force and effect in 1929, when the instant transactions occurred, were reasonable and consistent with the statute.

7. The Board erred in concluding and deciding that petitioner's transactions in its own common capital stock were not in the category of capital transactions.

8. The Board erred in concluding and deciding that the status of this stock while in the hands of petitioner is of small concern or moment in this case—in view of the fact that the basic and fundamental reasoning and philosophy underlying the regulations, rulings and decisions, for approximately 20 years, was that the status of such stock was that of treasury stock and that the issuance and sale of treasury stock is a transaction involving the capital structure of the corporation and as such is a capital transaction, and that the proceeds of treasury stock do not result in income to the corporation.

9. The Board erred in concluding and deciding that the status of the said stock in petitioner's possession was largely a matter of intent.

10. The Board erred in concluding and deciding that the immediate profit motive was present in the instant transactions, and especially was such conclusion and decision erroneous in view of the fact that the Board found and set forth facts to the contrary in its "Findings of Fact" and stated in its "Opinion" that "there is no testimony that the immediate profit motive was present". ("Findings of Fact", bot. of par. 4; par. 7; top of par. 8; par. 9; mid. par. 12; mid. par. 14; mid. par. 15; mid. par. 18. "Opinion", 2nd sentence in par. 19; par. 20.)

57 11. The Board erred in concluding and deciding that the immediate profit motive was present and interlarded the entire situation in the instant transaction; for that, the said conclusion and decision is unsupported by any testimony ("Opinion," par. 20) and is contrary to all the testimony in the record of this cause.

12. The Board erred in concluding and deciding that the issue in the instant cause is ruled by the decision in S. A. Woods Machine Co., 57 F. (2d) 635, which said case was decided upon a state of facts and upon a principle unrelated to those of the instant case, since that decision turned upon a principle wholly and clearly apart from the principle involved herein.

13. The Board erred in concluding and deciding that S. A. Woods Machine Co., supra, and the other decisions cited in paragraphs 14 and 16 of the "Opinion" are at variance with the principle and decision in Simmons & Hammond Mfg. Co., 1 B. T. A. 803, and the numerous decisions of the Board which follow the latter decision; for that, the S. A. Woods case (and the cases which follow it) support only the principle that where a corporation realizes a profit in a transaction which is otherwise taxable, such profit will not go unrecognized as such merely because the medium of payment in such profit transaction

consisted of the stock of the selling corporation; whereas Simmons & Hammond, supra, and the cases which follow it support the principle that the acquisition by a corporation of treasury stock for cash and its re-issuance for cash is a capital transaction and not an income transaction; which said last mentioned rule was carefully and repeatedly distinguished and approved in the cases supporting the rule in the S. A. Woods case.

14. The Board erred in concluding and deciding that while Simmons & Hammond Mfg. Co., supra, has not been specifically overruled, it has been indirectly overruled by decisions mentioned in the Board's opinion.

15. The Board erred in concluding and deciding that under Treasury Decision 4430 the transactions here in question were taxable transactions.

58 16. The Board erred in concluding and deciding to approve the Commissioner's contention that in the instant transactions the petitioner was "trafficking" in its own stock as it might "traffick" in the shares of another corporation, which said conclusion and decision was not based upon findings of fact to such effect, and was not based upon any evidence in the instant record.

17. The Board erred in concluding and deciding that the construction of the 1928 Act (such construction being announced in a Treasury Decision in 1934 and incorporated in the regulations in 1935 under a subsequent revenue act, and such construction being in conflict with the construction which had obtained under all previous revenue acts) was the only tenable construction which could be placed upon the 1928 Act.

18. The Board erred in concluding and deciding that Treasury Decision 4430 should be applied retroactively to transactions occurring approximately 6 years before its promulgation, which said transactions were made in light of regulations, rulings, opinions, and decisions of the Treasury Department and of the Board of Tax Appeals which were in force and effect at the time such transactions were made.

19. The Board erred in concluding and deciding that Treasury Decision 4430 applies to the transactions here in question or renders such transactions taxable.

20. The Board erred in failing to decide that the transactions in question were capital transactions and not income transactions.

21. The Board erred in failing and refusing to decide for the petitioner.

22. The Board erred in deciding for the respondent.

23. The Board erred in adding to petitioner's taxable net income for 1929 the above mentioned amount of $286.581.21.

24. The Board erred in entering its decision and order of July 16, 1937, stating that there is a deficiency in income tax for the year 1929 in the amount of $37,865.62.

59 25. The Board erred in that its opinion and decision are not supported by the evidence but are contrary to the evidence, and are contrary to law.

Wherefore, petitioner prays that the Circuit Court of Appeals for the Fourth Circuit may review the action, decision, and order of the Board of Tax Appeals in this cause, and direct the entry of a decision by the said Board in favor of the petitioner, determining that there is no deficiency in petitioner's income tax for the year 1929 arising upon the transactions which constitute the subject matter of this appeal and that the Clerk of the said Board be directed to transmit and deliver to the Clerk of this Court certified copies of all and every of the documents necessary and material to the presentation and consideration of the foregoing petition for review, as required by the rules of this Court and by statutes made and provided; and for such other and further relief as may to this Court appear proper in the premises.

(s) J. G. KORNER, Jr.,
(s) D. H. BLAIR,
(s) M. A. BRASWELL,
Attorneys for Petitioner-Appellant,
404 Transportation Building, Washington, D. C.

[*Duly sworn to by S. Clay Williams; jurat omitted in printing.*]

60 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Notice of filing petition for review

Filed October 12, 1937

To Honorable HERMAN OLIPHANT,
General Counsel, Treasury Department,
Washington, D. C.

SIR: You are hereby notified that the above named petitioner did on the 12th day of October 1937 file with the Clerk of the United States Board of Tax Appeals of Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Fourth Circuit of the Decision of the Board heretofore rendered in the above entitled case. A copy of the Petition for Review and the assignments of error as filed is hereto attached and served upon you.

J. G. KORNER, Jr.,
D. H. BLAIR,
M. A. BRASWELL,
Attorneys for Petitioner-Applicant,
404 Transportation Building, Washington, D. C.

Personal service of the above and foregoing notice, together with the copy of the Petition for Review and assignments of error mentioned therein, is hereby acknowledged this 12th day of October 1937.

J. P. WENCHEL,
Assistant General Counsel,
Bureau of Internal Revenue.

61 Before United States Board of Tax Appeals

[Title omitted.]

Stipulation of facts

Filed at Hearing April 27, 1936

It is hereby stipulated by and between the above named petitioner and the Commissioner of Internal Revenue, through their respective attorneys, that the following facts are true and that the Board may incorporate the same into its findings of fact, subject to the right of either party to introduce additional evidence not inconsistent herewith.

1. The petitioner, R. J. Reynolds Tobacco Company, is a corporation organized in 1899, under the laws of the State of New Jersey; its principal office and place of business is Winston-Salem, North Carolina. Its Federal income tax return for 1929 was filed with the office of the Collector of Internal Revenue for the District of North Carolina.

2. The petitioner is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco and cigarettes.

3. There is attached hereto, marked Exhibit A, and made a part hereof, a statement correctly showing in outline form the capital structure of the petitioner during all the years since its organization as a corporation.

4. There was no authorization during 1929 by charter amendment whereby the authorized number, class, or par value of petitioner's shares of stock were increased or decreased. The following represents the total capitalization of R. J. Reynolds Tobacco Company during the year 1929:

62

1,000,000 shares Common stock at $10.00 par value	$10,000,000
9,000,000 shares New Class B Common stock at $10.00 par value	90,000,000
10,000,000 shares outstanding capital stock	100,000,000

5. There is attached hereto, marked Exhibit B, and made a part hereof, a photostat copy of a typical certificate of the New Class B Common stock of the petitioner, referred to in paragraph 4 hereof.

6. During the year 1921, the R. J. Reynolds Tobacco Company acquired, for cash in the amount of $607,200.96, outstanding fully paid up certificates which as the result of subsequently declared stock dividends and subsequently effected split ups came to represent 75,000 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company; and on January 31, 1929, the said company still held the certificates so acquired. In the year 1929 (and after January 31, 1929) the R. J. Reynolds Tobacco Company cancelled certificates so held by it as aforesaid, representing 15,000 shares (of the said 75,000 shares held by it on Jauary 31, 1929, as aforesaid) and issued in lieu thereof new certificates representing 15,000 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company to divers persons who delivered to the R. J. Reynolds Tobacco Company

the sum of $708,690.00, in cash, in consideration for the issuance to them of the said certificates representing 15,000 shares of New Class B Common Stock of the R. J. Reynolds Tobacco Company. The said certificates representing 15,000 shares of New Class B Common Stock acquired by R. J. Reynolds Tobacco Company in 1921, as set out hereinabove, were so acquired by it for $121,440.19 in cash.

7. During the year 1929, the R. J. Reynolds Tobacco Company acquired for cash in the amount of $4,908,966.17, certificates representing 94,500 outstanding fully paid up shares of New Class B Common Stock of R. J. Reynolds Tobacco Company: and later in the said year 1929, the said company cancelled the said certificates representing the said 94,500 shares, and issued in lieu thereof new cer-
63 tificates representing 94,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company to divers persons who delivered to the R. J. Reynolds Tobacco Company, in the said year 1929, the sum of $4,506,497.00 in cash, in consideration for the issuance to them of the said new certificates representing 94,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company.

8. During the year 1929 the R. J. Reynolds Tobacco Company acquired for cash in the amount of $4,601,807.43 certificates representing 99,500 outstanding fully paid up shares of New Class B Common Stock of R. J. Reynolds Tobacco Company; and later in the said year 1929 the said company cancelled the said certificates representing the said 99,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company and issued in lieu thereof new certificates representing 99,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company to divers persons who delivered to the R. J. Reynolds Tobacco Company in the said year the sum of $4,703,608.00 in cash in consideration for the issuance to them of the said new certificates representing 99,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company.

9. The transactions referred to in paragraphs 6, 7, and 8, supra, were cash transactions; none of such transactions were made on margin.

10. Throughout the year 1929 the stock books and stock records of R. J. Reynolds Tobacco Company, in which were recorded the number of its capital shares (New Class B Common Stock) issued and outstanding, indicated that the number of such said shares, at all times during the said year 1929, was 9,000,000 shares. From the time of acquisition of the certificates representing shares of R. J. Reynolds Tobacco Company until the time of their cancellation and the issuance of new certificates in lieu thereof, all of which is more specifically set forth in paragraphs 6, 7, and 8, supra, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of the petitioner, as illustrated by the Financial Statement of R. J. Reynolds Tobacco Company for the year 1928, a copy of which is hereto attached and marked Exhibit C and made a
64 part hereof, in which all of such stock on hand at the beginning of the year 1929 was carried under the entry "Investments in

Non-Competitive Companies," and in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of the company as either increasing or reducing the number of the outstanding shares of its capital stock. At the times of the acquisitions by petitioner of certificates representing its capital stock, as set forth hereinabove, the cash of the petitioner was reduced by the amounts of cash expended for their acquisition. Likewise, at the times in 1929 when the said certificates were disposed of, as set forth hereinabove, the cash of the petitioner was increased by the amounts of cash received by the petitioner by reason thereof, as set forth hereinabove.

11. In the year 1921 the R. J. Reynolds Tobacco Company acquired, for cash, certificates representing a number of shares of R. J. Reynolds Tobacco Company New Class B Common Stock, and on January 31, 1929, the said company still held certificates so acquired, representing 75,000 shares of New Class B Common Stock. The said certificates representing the said 75,000 shares had been acquired by the R. J. Reynolds Tobacco Company, as aforesaid, for cash in the amount of $607,200.96. When in 1929 the R. J. Reynolds Tobacco Company cancelled certificates representing 15,000 shares and issued new certificates representing 15,000 shares, as set out in paragraph 6, supra, the certificates so cancelled, repre*presenting* 15,000 shares, constituted a portion of the acquisition in 1921, hereinabove set out. As stated in paragraph 6, supra, the acquisition by R. J. Reynolds Tobacco Company of the certificates representing the said 15,000 shares was for cash in the amount of $121,440.19.

12. During each of the years 1924 to 1928, inclusive, the petitioner, R. J. Reynolds Tobacco Company, reissued, solely for cash, certain shares of its New Class B Common Stock, theretofore acquired solely for cash, in a manner similar to that set out above herein with respect to the year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the
65 said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive, and for no other purpose, it is agreed that, in executing its income tax returns for each of such prior years, the petitioner noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus," and under subtitle (of said Schedule L) entitled "2. Non-taxable income: . . . . (f) Other items of Non-Taxable Income (to be detailed)" under the notation "Profit R. J. R. Stock," or substantially similar notation, the following amounts:

Years	Amounts
1924	$999,335.25
1925	601,507.42
1926	85,003.70
1927	240.83
1928	1,271,023.19

The form of the notation in the tax return for each of said years, as referred to above, is illustrated by the notation contained in item "2 (f)" of "Schedule L" of the income tax return for the year 1929, a copy of which is attached hereto, marked "Exhibit D" and made a part hereof.

13. In his examination and audit for the said year 1929, the Commissioner has not heretofore included as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited.

14. It is the intent and desire of the parties hereto to dispose of (by agreement with the approval of the Board of Tax Appeals) all of the issues presented in the petition filed herein on May 4, 1933. In the deficiency letter dated April 2, 1933, from which this appeal was taken, the Commissioner determined that the petitioner realized a taxable profit for 1929 of $145,475.44 from the liquidation of the Tobacco Foil Company, Richmond, Virginia, and/or Winston-Salem, North Carolina. It is hereby stipulated and agreed that, for the purposes of this appeal, such profit should be reduced to $71,196 64. It is further agreed that the net taxable income for 1929, in the
66 amount of $38,497,056.05, as determined by the Commissioner (in the said deficiency letter) should be reduced by $74,278.80—being the difference between $145,475.44 and $71,196.64, above mentioned; the tax should be recomputed accordingly.

15. By reason of the addition to taxpayer's net taxable income of the amount of $71,196.64, as set out in paragraph 14 hereinabove, the taxpayer's income tax due thereon to the State of North Carolina amounts to $2,774.31, and the similar income tax to the State of Virginia amounts to $16.61, both of which said amounts properly constitute deductions in computing the net taxable income of this taxpayer for purposes of Federal income tax. It is, therefore, stipulated that in the final computation of deficiency in the instant cause, the said amounts of $2,774.31 and $16.61 should be allowed as additional deductions from income of this taxpayer; the tax should be recomputed accordingly.

M. A. BRASWELL,
J. G. KORNER, JR.,
Counsel for Petitioner.
HERMAN OLIPHANT,
General Counsel for Department of the Treasury.
Counsel for the Respondent.

Exhibit A to stipulation

CAPITALIZATION

Resume of Stock Increases.—The original issue of common stock was increased from $2,100,000 to $3,600,000 in 1901, to $5,000,000 in 1902, to $7,525,000 in 1906, and to $10,000,000 in October, 1912. On April 2, 1913, $10,000,000 preferred stock was authorized, which was increased to $20,000,000 on Nov. 1, 1917. On the latter date an issue

of $10,000,000 class "B" common (par. $100) was also created. Under recapitalization plan June 24, 1920, preferred stock was increased to $50,000,000 and common stock was increased by $70,000,000 "New Class B" common (par $25).

67 Stock Offerings—Preferred stock was offered to holders of original common stock at par, as follows: $2,500,000 in November, 1914; $2,500,000 in February, 1917, and $5,000,000 in May, 1917. In Nov. 1919, $10,000,000 preferred was offered to common and Class "B" common holders. Class "B" common stock was offered to holders of old common, at par, $5,000,000 in February, 1918, and $5,000,000 in May, 1918.

New Capital Readjustment Plan.—On June 24, 1920, the shareholders approved: (1) an increase in the authorized preferred stock from $20,000,000 to $50,000,000; (2) creation of $70,000,000 "New Class B Common Stock," par $25, with same dividend rights as common; (3) reduction of par value of common stock from $100 to $25, the shares to be exchanged on a 4 for 1 basis. The "New Class B Common" shares ($25 par) exchanged for old "B" common shares ($100 par) on a 4 for 1 basis.

Charter Amendment Ratified—Preferred Stock and $100 Par "B" Stock Eliminated.—As a result of the redemption at Jan. 1, 1926, of all the outstanding preferred stock, the provision of the company's charter authorizing $50,000,000 of this stock became obsolete. In addition the provision of the charter authorizing $10,000,000 of $100 par B stock was obsolete ever since the company reduced the par value of its B stock to $25 per share. On April 6, 1926, the stockholders of the company approved the recommendation of the Directors to eliminate from the charter all provisions for stocks not in use. This was accomplished by changing the authorization for preferred stock and $100 par B stock, amounting together to $60,000,000, into that amount of $25 par B stock identical with that then outstanding.

Two and One-Half for One split-Up of Common and Class "B" Common Approved.—Dec. 28, 1928, stockholders reduced the par value of common and common "B" shares from $25 to $10 per share and approved the split-up of each $25 par value share into 2½ shares of $10 par value.

Stock Dividends.—On Aug. 16, 1920, a stock dividend of
68 200% in new class "B" common stock was paid on the $10,000,000 common stock and the $10,000,000 Class "B" common stock.

On Dec. 2, 1922, a stock dividend of 33⅓% in new Class "B" common stock was paid on the $10,000,000 common stock and $50,000,000 new Class "B" stock.

On Jan. 13, 1927, the Board of Directors declared a stock dividend of 25% on the common stock and new class B common stock, payable Feb. 15, 1927, in new Class B common stock at par, to holders of record of company's common and new class B common on Feb. 1, 1927.

Preferred Stock Retired.—The entire outstanding 7% cumulative preferred stock was retired at $120 per share and accrued dividends at Jan. 1, 1926.

STOCK PROVISIONS

Preferred stock (now retired) had preference as to assets as well as dividends (7% cumulative) and was redeemable at 120 after three years from date issued.

New Class "B" common stock has the same dividend rights and privileges as the old common, except that it has no voting power.

The new Class B shall not be considered under the company's plan providing for participation by officers and employees in certain profits of the company.

Exhibit C to stipulation

R. J. REYNOLDS TOBACCO COMPANY, WINSTON-SALEM, N. C.

FINANCIAL STATEMENT

December 31, 1928

WINSTON-SALEM, N. C., *January 14, 1929.*

To the Stockholders of R. J. Reynolds Tobacco Co.:

69 The Financial Report of your Company at the close of business December 31, 1928, is hereby submitted.

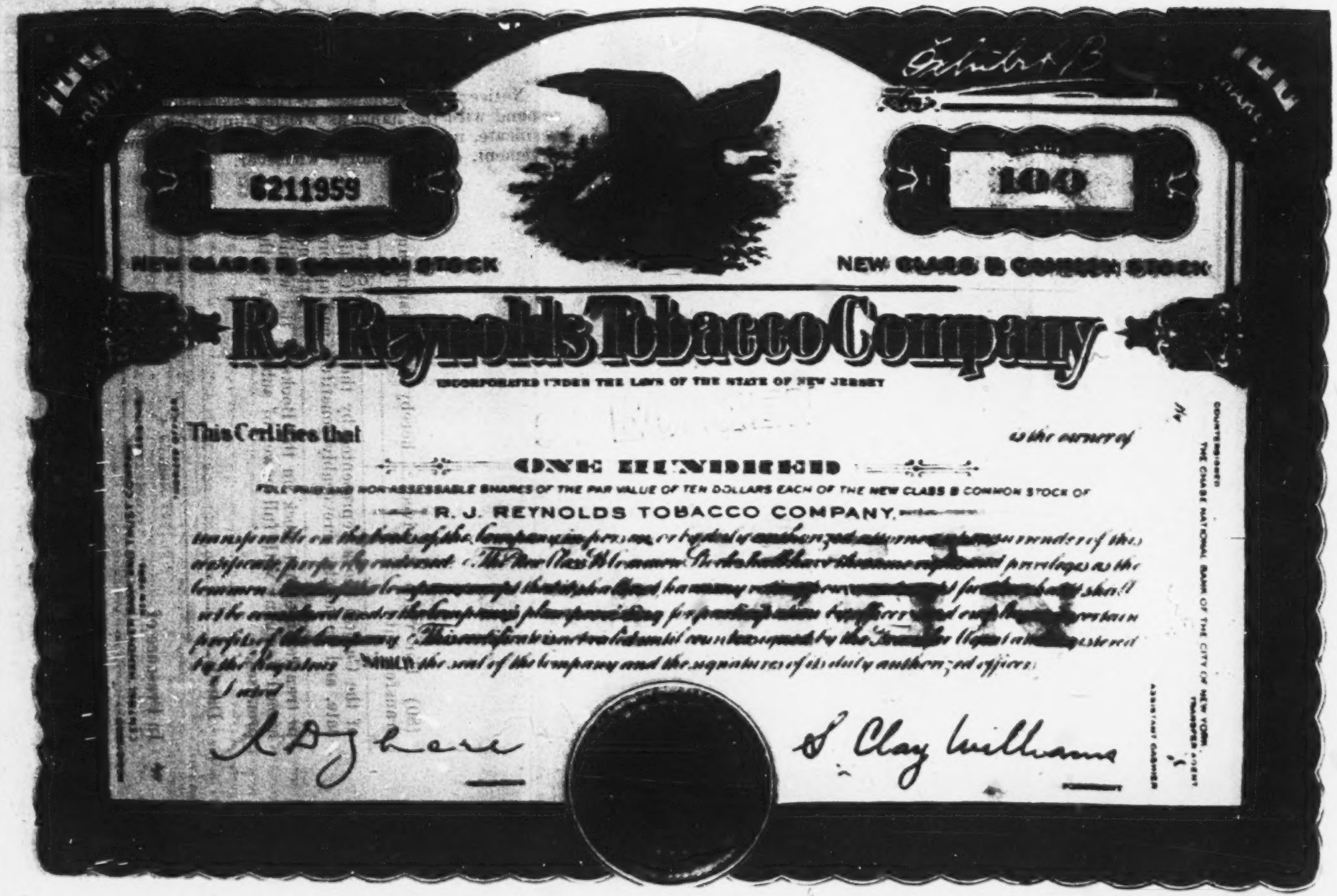
Net Earnings for the year 1928, after deducting all charges and expenses of management, and after making provision for Interest, Taxes (including Federal and State Income Taxes), Depreciation, Advertising, etc	$30,172,563.17
Deduct: Four quarterly dividends of $1.25 each and ore extra dividend of $1.50 per share	26,000,000.00
Balance carried to Undivided Profits	4,172,563.17
Add: Undivided Profits, December 31, 1927	40,696,774.85
Total Undivided Profits December 31, 1928	$44,869,338.02

Exhibit C, Financial Statement, December 31, 1928

ASSETS

Current:			
Cash		$14,958,887.30	
U. S. Treasury Certificates		12,000,000.00	
Accounts Receivable (net) for merchandise sold		11,222,163.65	
Leaf Tobacco, Supplies, Manufactured Product		97,595,012.34	$135,776,053.29
Other assets:			
Real Estate, Buildings, Machinery, Fixtures	$24,694,177.48		
Less Depreciation, Obsolescense, etc	8,146,122.46	16,548,055.02	
70 Investments in Non-Competitive Companies, etc		945,612.69	
Bills and Notes Receivable		211,305.10	
Other Accounts Receivable		2,287,666.39	
Brands, Trade-Marks, Good Will		1.00	
Prepaid Expenses		491,606.86	20,484,247.06
			$156,260,300.35

Exhibit B



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Notice: The signature to this assignment must correspond with the name as written upon the face of the certificate, in every particular, without alteration or enlargement, or any change whatever.

(80) For value Received ..... hereby sell, assign and transfer unto .....

..... Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint ..... Attorney to transfer the said stock on the Books of the within-named Company with full power of substitution in the premises.

Dated, ...

In Presence of

.....

.....

THIS SPACE MUST NOT BE COVERED IN ANY WAY

Exhibit D to stipulation

(c)

(d)

11. Total Income as Items 3 to 10

DEDUCTIONS

12. Compensation of Officers (From Schedule C)

13. Rent on Business Property

14. Repairs (From Schedule D)

15. Interest

16. Taxes (From Schedule E)

17. Losses (From Schedule F)

18. Bad Debts (From Schedule G)

19. Dividends (From Schedule H)

20. Depreciation (resulting from exhaustion, wear and tear, or obsolescence) (From Schedule I)

21. Depletion of Mines, Oil and Gas Wells, Timber, etc. (From schedule, see instruction 10)

22. Other Deductions Not Reported Above. (Itemize when of an unusual nature)

(a) Salaries and wages. (Not deductible to extent disallowed)

(b) Net Loss for prior year. (See instruction 11)

(c) Additional discount allowed. 16 [illegible]

(d)

(e)

(f)

23. Total Deductions as Items 12 to 22

24. Net Income (Item 11 minus Item 23)

COMPUTATION OF TAX

25. Net income (Item 24 above)	$	38	351	686	53	29. Income Tax (See [illegible] of Item 28)			
26. Less: Credit of $2,000 for a domestic corporation having a net income of less than $25,000						30. If return is filed by Consolidated corporation, see instruction 13, and enter the amount over $25,000			
27. Balance (Item 25 [illegible] Item 26)	$	38	351	686	53	31. Total Tax (Item 28 plus Item 29)			
31. Less: Income Tax Paid [illegible] (This credit can only be allowed to a nonresident foreign corporation)									
32. Income Tax Paid to a Foreign Country or U. S. possession by a domestic corporation (see Inst. 27)									
33. Balance of Tax (Item 31 minus Items 31 and 32)									

An amended return must be marked "Amended" at top of return

Checks and drafts will be received only [illegible]

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Less reserve for depreciation	$ 11	945	076	12					$ 14	557	904	03						
	7	782	676	47	14	143	499	71	7	798	488	73	16	799	414	87
8. Patents						1	676	48							836	88
10. Good will							1	00							1	00
11. Other assets (describe fully):																
Cameron Park Development	$	509	766	20					$	516	832	68				
Dunlieth Avenue		34	853	99						53	344	33				
Employees Real Estate Account		62	306	18		716	035	00		48	594	86		694		
Bldg. & Mchry. Const. Account,		109	106	85							676	50				
12. TOTAL ASSETS					153	301	177	00					160	705		
LIABILITIES																
13. Notes payable (less than one year)					$								$			
14. Accounts payable					2	865	876	41					3	457	886	94
15. Bonds and notes (not secured by mortgage)																
16. Mortgages (including bonds and notes so secured)																
17. Accrued expenses:																
Interest	$								$							
Taxes					5	558	728	49					5	725	858	94
All other																
18. Other liabilities (describe fully)																
19. Capital stock:																
Preferred stock (less stock in treasury)	$								$							
Common stock (less stock in treasury)					100	000	000	00					100	000	000	00
20. Surplus	$								$							
21. Undivided profits					44	876	572	10					51	322	072	41
22. TOTAL LIABILITIES					153	301	177	00					160	705	217	88

Remarks

A2

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[redacted]

QUESTIONS

[redacted]

and also the leasing of such property. State the product or products, mining and quarrying, including oil and gas wells, and also the leasing of property. State the product or products. C.—Manufacturing. State product and also the material if not implied by the name of the product. [illegible] conservation, building, repair, grinding, shop, etc., also exploring and installing mains with fixtures, pumps, or machinery, without their manufacture. State nature of business (gas, machinery sold, or kind of installations). III.—Transportation [illegible] etc. State the kind and special product transported, if any. IV.—Public utilities [illegible] (natural, coal, or water); electric light or power ([illegible] generated); heating (steam or hot water); telephone; conveyance, or power. V.—Storage, without trading or profit from sales—(elevators, warehouses, [illegible], etc.). State product stored. VI.—Leasing transportation or utilities. State kind of property. F.—Trading in goods bought and not produced by the trading concern. State manner of trade, whether wholesale, retail, or commission, and product handled. Sales with storage with profit primarily from sales. G.—Service—domestic, (including hotels, restaurants, etc.; amusements; other professional, personal, or technical service. State the service. H.—Finance, including banking, real estate, insurance. I.—Concerns not falling in above classes (a) because of combining several of them with no predominant business, or (b) for other reasons.

2. Concerns whose business involves activity falling in two or more of the above general classes, where the same product is concerned, should report business as identified with but one of the above general classes; for example, concerns in A or B which also transport and market their own product exclusively or mainly, should still be identified with classes A or B; concerns in C (manufacturing) which own or control their source of material supply in A or B and which also transport, sell, or install their own product exclusively or mainly, should be identified with manufacturing; concerns in D may control or own the source of supply of materials used exclusively or mainly in their construction work; concerns in E1 or E2 may own or control the source of their material or power; concerns in F may transport or store their own merchandise, but its production would identify them with A, B, or C.

3. Answers:

(a) General class (use key letter designation) C - Tobacco Products

(b) Main income-producing business (give specifically the information called for under each key letter, also whether acting as principal, or as agent on commission; state if inactive or in liquidation)

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AFFILIATIONS WITH OTHER CORPORATIONS

SEE INSTRUCTION 10

4. Is this a consolidated return of two or more corporations? .....
If so, procure from the Collector of Internal Revenue for your district Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of this return. See Article 77 (c) and (d), Regulations 75.

5. Did the corporation file a consolidated return for the preceding taxable year? ..... Answer

If "yes," give name and address of any predecessor business, and the date of the change in entity. .....

.....

.....

Upon such change were any asset values increased or decreased? .....
If the answer is "yes," closing balance sheets of old business and opening balance sheets of new business must be furnished.

BASIS OF RETURN

7. Is this return made on the basis of actual receipts and disbursements? .....
If not, describe fully what other basis or method was used in computing such income. Accrual Basis

.....

VALUATION OF INVENTORIES

8. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. If other basis was used, describe fully, state why used and the date inventory was last reconciled with stock. .....

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LIST OF ATTACHED SCHEDULES

Enter below a list of all schedules accompanying this return, giving for each a brief title and the schedule number. The name and address of the corporation should be placed on each separate schedule accompanying the return.

Schedule Compensation of Officers

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.....

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.....

.....

The corporation's books are in care of .....

Located at .....

a3

U. S. GOVERNMENT PRINTING OFFICE : 1930 — O- 116400

SCHEDULE D—COST OF REPAIRS (See Instruction 14)

1. Items	2. Amount (Enter on line 10)
Labor and wages Brass & Iron,	$ 4,704 39
Pipe & Fittings,	11,442 48
Electrical Supplies,	7,483 23
Machinery parts,	6,105 72
[illegible]	28,006 79
Others,	10,049 47
	$ 67,793

SCHEDULE E—TAXES PAID (See Instruction 15)

1. Items	
Franchise,	
State, City & County Property	
Taxes,	
N. C. & Va. State Income Taxes,	
	$

SCHEDULE F—EXPLANATION OF LOSSES BY FIRE, STORM, ETC. (See Instruction 17)

1. Kind of Property	2. Date Acquired	3. Cost or Value as of March 1, 1913, if Given Thereon	4. Depreciation Sustained	5. Amount of Insurance	6. Loss
		$	$	$	$

State how property was acquired

SCHEDULE G—BAD DEBTS (See Instruction 18)

1. Year	2. Sales on Account	3. Bad Debts
1923	$	$
1926		
1927		
1928		241,554 27
1929		

SCHEDULE H—DIVIDENDS DEDUCTIBLE (See Instruction [illegible])

1. Name of Corporation	Amount of Dividends: 2. Preferred	3.
R.J.Reynolds Tob. Co.	456,127 10	
Mac.Andrews & Forbes Co.	28,032 60	
L. S. Young Co.,	4,910 00	
Glenn Tob. Co.	1,026 66	
	490,166 36	

SCHEDULE I—EXPLANATION OF DEDUCTION FOR DEPRECIATION (See Instruction 20)

1. Kind of Property (If buildings, state material of which constructed)	2. Date Acquired	3. Age When Acquired	4. Reasonable Life After Acquisition	5. Cost or Value as of March 1, 1913, Whichever Applies (Number of Lots)	6. Amount of Depreciation Claimed: Previous years	7.
Building,				$	$	320,
Machinery & Fixtures,						596,
Furniture & Fixtures,						18,
Motor Trucks,	(SEE SCHEDULES ATTACHED)					17,
Ford Automobiles,						172,
						1,023,

AFFIDAVIT

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith for the taxable year stated, pursuant to the Revenue Act of 1928 and the Regulations promulgated thereunder.

Subscribed and sworn to before me this 15th day of March, 1930.

Maurice M. Ward, Notary Public

(SEAL) (CORPORATE SEAL)

Attach a separate sheet if any of the above schedules do not provide sufficient space.

My commission expires May 4, 1931.

U. S. GOVERNMENT PRINTING OFFICE : 1928 — O- 116489

short period at the beginning of the year 1928, the tobacco market was moving slightly downward. This was followed by an upward movement of about two months and then was followed by a substantial movement downward. The effect of this price cut is shown by the steep drop at that point. That presented an opportunity for acquiring some stock at a cost low enough to give us a chance to make it attractive to desirable stockholders.

In 1924, no stock was acquired but 21,067 shares of the 1921 acquisition was reissued. In 1925, no stock was acquired but 11,000 shares of the 1921 acquisition was reissued. In 1926, we acquired 21,400 shares under the special circumstances outlined above and in the same year reissued these 21,400 shares. In 1927, no shares were acquired and none were reissued, although we made disposition of the fractional shares which accrued to the company by reason of failure to exercise stock rights. In 1928 we acquired 43,300 shares under the special circumstances outlined above, and reissued all of them in the same year. All of the acquisitions above referred to were for cash and for no other consideration and all of such stock was reissued on receipt of cash and for no other consideration.

During all the years from 1921 through 1928, the company never bought or sold the shares of any other corporation. This is also true as to 1929, except that in that year, the company liquidated a small corporation, the stock of which it had acquired at some time prior to 1917. This was an investment which was disposed of in that year and the company has admitted the tax liability in the transaction of the Tobacco Foil stock. The company has, for a number of years, owned some stock in the Glenn Tobacco Co., none of which stock was ever for sale. With these exceptions the transactions relative to its own stock constitute the only acquisitions or dispositions of stock by this company. The company's charter does not authorize it to deal in tobacco stocks. None of the profit
92 represented in the liquidation of the Tobacco Foil Co. is involved in the present controversy. The stock of the Glenn Tobacco Co. is an investment which is still owned by the company.

None of the shares of the company's common stock was ever acquired by the company as a medium of payment in any transaction in which the Reynolds Company sold a commodity or an asset at a profit. We were following a policy of getting as much common stock as possible for distribution among employees for cash, along with the policy of handling the new Class B stock. There may have been a possibility that in small amounts some Class B stock may been exchanged for Class A stock, when Class A stock was disposed of for cash and in no instance for anything except cash. I do not know that any such exchange as that took place. What I mean is that some Class A stock may have been acquired in exchange for B stock and then the Class A stock sold to an employee for cash. But none of such transactions are involved in the year 1929.

Re-Direct Examination by Respondent-Appellee

The shares owned by the officers and directors of the company were more substantial than the average of all the employees. They were the largest of the holdings of the employee group and they were the owners of substantial blocks of stock. The company's action in 1929 which served to protect the interests of the stockholders of the company necessarily served to protect the officers and directors who were stockholders. Class B was a non-voting stock and always has been. The new Class B stock was also a non-voting stock. Class A stock is a voting stock and is largely owned by the officers and employees of the company. It is true that in 1929 some of the officers and directors held stock which was not fully paid for. These people were not in danger and many of them lent collateral to help weaker employees hold theirs. At the end of 1928 there were 30,000 shares of $25 par value Class B stock which became, on January 31, 1929, 75,000 shares of $10 par value Class B stock. This was due to a reorganization split-up of the stock, 2½ shares for one. This constituted a part of the acquisition from United Retail Stores in
93 1921. The total number of shares of $10 par Class B stock which was held by the company at December 31, 1929, was 431,925 shares.

* * * * * * *

Copies of each of the following exhibits are attached hereto and made a part hereof:

1. Stipulation of certain material facts, executed by the parties and filed with the Board at the hearing.
2. Exhibit A—Statement of capitalization of petitioner corporation, attached to and made a part of Paragraph 3 of the stipulation of the parties above referred to.
3. Exhibit B—Copy of specimen stock certificate of Class B stock, attached to and made a part of Paragraph 5 of the stipulation of the parties above referred to.
4. Exhibit C—Financial statement of petitioner corporation for the year 1928, attached to and made a part of Paragraph 10 of the stipulation of the parties above referred to.
5. Exhibit D—Schedule L of income tax return of petitioner corporation for the year 1929, attached to and made a part of Paragraph 12 of the stipulation of the parties above referred to.
6. Exhibit E—Financial statement of petitioner corporation for the year 1929.
7. Exhibit No. 3—Copy of the charter of petitioner corporation.

The foregoing is the substance of the testimony adduced at the trial of said proceedings.

J. G. KORNER, JR.,
D. H. BLAIR,
M. A. BRASWELL,
Counsel for Petitioner.

48

SCHEDULE — COST OF MANUFACTURING OR PRODUCING GOODS SOLD [illegible]

[illegible]

Printing [illegible]

[illegible] Wrapping [illegible]

[illegible] Material [illegible]

[illegible] Advertising

Expense.

SCHEDULE — PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. [illegible]

Test Set. & Blades	[illegible]	[illegible]
Typewriters [illegible]	[illegible]	[illegible]
Motor Trucks	[illegible]	[illegible]
Machinery	[illegible]	[illegible]
Ford Cars	[illegible]	[illegible]
U.S. Treas. Certificates	[illegible]	[illegible]

SCHEDULE C — DEPRECIATION [illegible]

[illegible]

LIABILITIES

Current:		
Accounts Payable	$3,777,139.14	
Accrued Taxes and other Accrued Accounts	5,762,683.75	$9,539,822.89
Reserves: Contingencies		1,851,139.44
Capital account:		
Common Stock	10,000,000.00	
New Class B Common Stock	90,000,000.00	
Undivided Profits (after deduction of dividends payable January 1, 1929)	44,869,338.02	144,869,338.02
		$156,260,300.35

Respectfully,

R. D. SHORE, *Treasurer.*

We hereby certify that we have examined the books of account and record of R. J. Reynolds Tobacco Company, Winston-Salem, N. C., at December 31, 1928, and it is our opinion that the above statement shows the true financial condition of the Company at the date stated, and that the accompanying Analysis of Undivided Profits Account is correct. Inventories of Leaf Tobacco, Supplies, Manufactured Product, and Investments are valued at cost as in former years. As far as we could ascertain there were no contingent liabilities and we were informed none existed.

ERNST & ERNST,
Certified Public Accountants.

77 In United States Circuit Court of Appeals for the Fourth Circuit

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER-APPELLANT

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT-APPELLEE

Board of Tax Appeals, Docket #71901

Condensed statement of evidence

Filed December 2, 1937

Hearing at Washington, D. C., April 27, 1936.

Above entitled cause came on for hearing on this the 27th day of April 1936, before Honorable ERNEST H. VAN FOSSAN, Member, pursuant to notice thereof, whereupon the following proceedings were had and testimony taken, to-wit:

Petitioner's counsel stated that all the issues presented in the petition had been agreed upon and stipulated and that all those issues have been eliminated from this case; that respondent had, by amended answer, raised a new and affirmative issue which constitutes the only issue remaining in the case; and that under the circumstances the

burden of going forward and sustaining his contentions are upon the respondent.

After statements by counsel for the respective parties had been made, outlining the contentions of the parties, evidence was introduced by the parties as follows:

78 EVIDENCE FOR RESPONDENT-APPELLEE

Without objection there was submitted into evidence a stipulation of certain material facts, executed by the parties; which said stipulation was read to the Board at the hearing. Said stipulation appears elsewhere in the instant Transcript of Record on Appeal.

TESTIMONY FOR RESPONDENT-APPELLEE

S. Clay Williams was called as a witness and, on oath, testified in substance as follows:

My name is S. Clay Williams. I reside in Winston-Salem, N. C., and am Chairman of the Board of Directors of R. J. Reynolds Tobacco Co. I have been continuously with that company since 1917. I was assistant general counsel from 1917 to 1921, and general counsel from 1921 to 1924. In 1924 I became an executive vice-president in addition to being general counsel. In 1931 I became president of the company. I was president until 1934, when I became Chairman of the Board.

I participated in the transaction in 1921 in which the company acquired a block of B stock which it sold in 1929. That stock was acquired in 1921 from United Retail Stores, which company held the stock of United Cigar Stores Company, which was a large distributor of all tobacco products. This stock was acquired at private sale. At that time Reynolds stock was not listed on any exchange. The price at which it was acquired was not subtsantially different from the price at which it was moving in regular sales, although it was slightly lower due to the size of the block of stock acquired. That was the only reason for the lower price. The certificates were delivered to the company and held by the company until 1929, except such portions as were disposed of in the meantime. The certificates were cancelled and the stock reissued.

Part of the total stock sold in 1929 was sold under options given to certain persons who undertook to effect a distribution thereof. Some other was sold in regular course. The company granted an option on it to some one to buy stock at a certain price and the optionee proceeded to make such disposition as he could and called
79 for delivery of the stock. The options ran for a short period.

Upon confirmation of these transactions the stock was endorsed in blank by our nominee and delivered to the optionee. We held the stock in the name of a nominee. The nominee held it for us and when we were called upon to make delivery we had our nominee endorse and deliver the stock. So far as the stock books of the company were concerned and speaking from the face of the stock books, there

was nothing to indicate any different handling of these certificates as against any other certificates. We in the executive department did not know these details in all instances. When the company uses some of its cash to take up shares of the company from a stockholder, and holds them and by holding them reduces the dividend requirements of the company at each dividend period, the effect is that the dividends on such stock come to the company, and that money goes out of one pocket and into another. We do not know whether, under the administration of the Bureau, such stock would be held as a matter of law to be a reduction in the capital stock of the company or whether it would be a straight purchase and re-sale. What we actually did was to cancel the certificates and issued new certifictes. The certificates stood in the name of our nominee all the time and through the period that they were so held. When we disposed of them they necessarily had to have and did have the endorsement of our nominee. Such endorsements were all in blank. The procedure was that the nominee endorsed them in blank, they came into the possession of the company endorsed in blank, they were cancelled, and new certificates were issued in lieu thereof to the purchaser according to the instructions of the optionee at the time. When dividends were declared on the stock held by the company they were paid to the company.

The stock purchased in 1929 was purchased in the market, the stock having been listed on the Exchange. It was bought through brokers at the market price. I think we made about 27 purchases, which totalled the 94,500 shares. They were acquired in October, November, and were sold on three different days during November and December. If the purchases be broken down into the individual shares shown on the stock books of the company as purchases, the number of such individual purchases would be enormously more, because
80 if the market was active and we were actively buying, then on each day there would be many purchases. Both purchases and sales were all made through brokers. In many instances Hutton & Co. was our selling agent. Another account was known as the Kenney Nominee Account. The certificates were endorsed in blank and kept in a depository. Another account was that of Horace E. Whitney, wherein we bought and sold 95,500 shares of outstanding fully paid up stock. Those purchases were made on two different days and the sales were made on two different days. Both purchases and sales moved through brokers, except such as moved under the options, if any did move under options. Such purchases and sales as moved through the market were made at the market. Any stock moving under option by previous agreement would move somewhat below the market for the reason that you can not sell a big block of stock at the price you would ordinarily sell a small block.

The company made report of these 1929 transactions in its tax return on Schedule L, which is a reconciliation statement of net income and analysis of change in surplus. In order for the books to reconcile with the tax return it was, of course, necessary for all the items in question to have appeared in our books, whether or not in the same form as in Schedule L of the return. The entries reflecting these

transactions were entered in our books as cash items. They went to our surplus to be included in a financial statement to the company's stockholders. In the return it was reported under the item or schedule entitled "Non-taxable Income" and "Other Items of Non-taxable Income" in the amount of $436,581.21, which figure was adjusted by the Commissioner to $286,581.21. That was by way of reconciling our tax return with our books, and the showing that it was a non-taxable profit was because of the Regulation, and in accordance with our understanding and theory of what it was. The item appears in Schedule L of the tax return as part of the reconciliation of net income and analysis of changes in surplus as between the corporate books of account and net income reported for taxation in the return. The company in 1929 acquired certain shares of its own stock which it did not reissue or dispose of in 1929, and such stock was carried on the company's books as "Investment in non-competitive companies." This
81 account carried the common stocks which the company had acquired for cash in 1929 and which it still had on hand at December 31, 1929, and such stock comprised substantially all of that account. Of the amount of $19,601,594.77 shown on Exhibit E, $19,270,690.98 represented Class B stock.

Cross-examination by Petitioner

When the company disposed of any of this stock the certificates therefor were surrendered up and cancelled, and new certificates were issued. This was true as to all transactions including those here involved wherein the stock was held in the interim by a nominee or nominees. This was equally true upon acquisition of shares by the company.

The stock which was acquired from United Retain Stores was acquired under a decision made in recognition of a special situation as well as a general company policy. It went back a number of years. In 1912, the company was a youngster, a small corporation composed of a few people, having been originally and for some years owned by one family until other stocksolders came in. It was in most vigorous competition with much larger companies. This presented a problem of keeping capitalization up to the point where the company could sustain itself in the expansion of its business, which was growing rapidly, and to keep enough people acquainted with and interested in its stock so as to be able to facilitate its business development. It was Mr. Reynolds' plan to have as many employees as possible take a stockholding interest in the business. The company had gone far by 1918, when it issued additional stock. In 1920 a stock dividend multiplied the stock by three and the surplus was capitalized in order to supply working capital.

In 1918 Class B stock was created. This stock did not have certain profit participation provisions which the original stock had. The result was that we put all our stockholders in possession of additional stock at $100 par and put into employee-stockholders a stock selling for an amount substantially above the amount they had

paid into the company; and this they could dispose of without interfering with their rights of participating in the profit distribution peculiar to their original stock. In this way we set up a situation under which new stock might come into the market, while
82 prior thereto the original stock had been held off the market.

This applied not only to employee-stockholders but to non-employee stockholders as well. With this new stock put on the market at $100 a share, and with a $10,000,000 capitalization, it would sell much above the amount paid in for it because of the increased value of the company. This opened up a possibility for the company's management in its problem of how to keep the company properly capitalized and also in the problem as to how to preserve the reputation of the company through the reputation of its stock. We had to keep ourselves in position for necessary expansion and, also, in an industry where competition was so intense and public sentiment so sensitive we had to meet the problem of preserving reputation of the company and of its stock, because the behavior of its stock affected the reputation of the company and affected the attitude of the consumer.

This move on the part of the company soon brought about a serious situation. Soon after this new stock was brought out in 1918, Mr. R. J. Reynolds died in July. He controlled the company. The company had just overcome one handicap by creating the new stock which could be sold without penalty to the stockholders and, upon the death of Mr. Reynolds, was confronted with the situation where his estate would have to sell an enormous block of stock. This was the situation which confronted us. We had a very small list of stockholders. There was a big amount of stock to be sold with no reasonable prospect of absorption. Out of that problem came the recognition that if we were to be safe in the future it would be absolutely necessary to get a broader stockholding base, so that when stock had to be sold for any reason we would have a sufficiently large group at least potentially interested in acquiring the stock, and thereby provide for its absorption.

Another aspect of the problem which compelled recognition was the fact that a large amount of the company's stock was held by non-local interests which were well known in the tobacco industry, such as Duke, Ryan, Widener, the Whitneys, and others who had been carrying a substantial interest. In the face of all these things we recognized, in 1918, the necessity of broadening the stockholding basis so as to avoid the chance, so far as we could avoid it, of ruining the reputation of the company's stock and injury to
83 the company and its brands, in an industry where the competition was so intense. We recognized that there was a possibility of our stock coming into the hands of unfriendly interests. We realized that the best policy was to get our stock into more hands and into the best possible hands whenever an opportunity arrived, in order to get the greatest possible protection against such situations as these.

That was the policy behind the purchase in 1921. A big block of this stock had come into the hands of United Retail Stores, which controlled United Cigar Stores Co., which was a large distributor of tobacco products all over the country. This was the block of stock which had to be sold by the Reynolds Estate in order to pay inheritance taxes. We were selling our products to the United Cigar Stores Co., a big distributor with probably 2,000 retail outlets. We were selling outright to them and also to thousands of other consumers. It became known that United Retail Stores owned a heavy block of stock in our company. When that information got around among the distributors it naturally aroused suspicion on the part of a good many that the United was possibly dictating the Reynolds' policy and that it might not be in the interest of distributors generally to have the company's policy dictated by one of the big distributors. This suspicion was false, but this did not eliminate the suspicion in the minds of our distributors as to its truth. The United publicized the fact that they owned a substantial block of our stock and this increased the suspicion that they were dictating our policy. This was hurtful to our business. Another suspicion that grew up was that if any one distributor owned so much stock he might be buying cheaper and getting better discounts and terms than others. This was not true, but the fact that it was not true did not protect us from the injury created by the suspicion.

Another situation existed which was a fact and not suspicion. That was that since United Retail Stores was the owner of such a heavy block of stock in our company, on which it received devidends, that company could pay dividends to its stockholders although it operated its business without any profit. This meant that the United could pay its dividend out of the dividends it received from our company. This was not wholesome for our company. The United published the fact
that they got enough dividends from Reynolds Company to give
84 it a nice income independent of its operations and this had a bad effect on us.

That was the picture which was in our minds at that time and through all the years which followed. After the above situation had developed we determined to get that block of stock, if we could, and use it to expand our stockholding list over whatever period of time it might take us and thereby protect ourselves against getting into such a situation again. The acquisition of this stock served two ends. It served to protect the company from a dangerous situation and it afforded an opportunity to put into effect our policy of expanding our stockholding base and prevent a raid on our stock in any way. The foregoing situation was behind our purchase of that stock in 1921.

In 1929 another situation developed. Our stock had been listed on the Exchange in 1922. This listing was another step in the pursuit of our policy of getting a wider stock distribution and a better market protection against an injury to the reputation of the stock. By 1929 it had developed that more than 2,000,000 shares of this stock had gotten into the hands of brokers. That was 23% of the total, and we realized that with that much stock in the hands of brokers the only reasonable

deduction was that it was not stock which had found investment holders but was being held for purposes of trading or speculation. We foresaw that if any disturbance came to the market this was a perfect situation in which this stock might be dropped into the market to the great detriment of the stock's reputation. Since the reputation of the company and the reputation of the company's brands and business were inseparably tied up with the reputation of the stock, we were confronted with a situation that might have very greatly injured the reputation of the stock and of the company and of its business.

In October 1929 the market gave some evidence of dropping. The big drop came late in October. With this situation before us the question was raised anew, as it had been raised when we were confronted with the situation in 1921, as to whether or not we could, under these circumstances, make purchases of our stock in service of that situation. The company had sufficient cash ($29,000,000 in cash and government securities) and, as was done in 1921, the question was referred to the company's law department as to whether or not, under the circumstances, the company could properly buy some of its stock. Our law department advised, as it had done in 1921, that under the special circumstances the company should adhere to its policy, under existing circumstances, and go forward and buy stock. We went into the market as the stock came down, first early in October and more precipitately later in October, and acquired this stock which was being offered in such volume. The volume of these offerings was caused by the fact that so much of it was in the hands of brokers; fully 23%. Our opinion as to the effect the crash might have on the company and the stock and the stockholders was that if, under the circumstances of the threatened crash and with the crash coming on, if nothing was done to support the market, the reputation of our stock with nearly ¼ of it in brokers' hands, presumably in a speculative position and not held as investment stock, the effect would be to destroy completely the reputation of the stock. The effect would have been that the stock would have sold at a price absurdly below its value and the business prospects of the company, because at that time the company was doing an unprecedented volume of business and was making entirely satisfactory and increasing profits.

At that time we had increased the number of employees who were holding common stock which is sometimes referred to by the nickname of "Class A Stock." Officially it is merely common stock. Under our policy of getting as many employees as possible to become owners of that stock, we had, by 1929, gotten the number of employees holding common stock up to a total of 2,000. Our objective was both to get a wider distribution of the stock and a greater interest on the part of the employees.

Another element presenting possibilities of disaster to the company if its stock were permitted to crash to a value representing only a fraction of its worth was this: Most of the employees, the smaller ones including the men in the factories, clerks and other classifications included in the 2,000, had borrowed quite liberally on their stock.

This was not true to the same extent on the part of the directors and officers; but among the minor employees it was true that they had borrowed, some of them all they could borrow. That presented a possibility of disaster to those men in their personal estates and, on top of that, in their relationship to the company. When you re-
86 member that this stock had at that time a book value of about $16 but had then been selling at 64, you can get some estimate of the contribution the stock gave to the reputation of the company, as well as the good will it had built up for itself and its friends and the morale it gave to the company's staff who had that value in their stock. Immediately before the crash the stock was worth 16 on the books but was selling at four times that on the market. A great deal, if not all, of the money that the employees had been borrowing on their stocks was for the purpose of purchasing company stock. We were, therefore, confronted with the special proposition of the effect of the distress of our stock on the morale of our staff. It not only affected their personal status but also their status with the company. The general reputation of the company and its stock was tied up with this situation. Competition was intensive and has always been so, particularly between the bigger companies in the cigarette business, and our competitors capitalize upon all such things just as they did in 1921.

We felt that if we suffered that situation to run its indicated course we would cause great injury to the reputation of the company's stock and its business, and hurt the company and the owners of its stock. So we decided to buy some of that stock as I have outlined. We gave orders to brokers to acquire such stock for us for cash. Our instructions were to acquire such stock at 50 and for a number of days to take at 50 all stock offered. After we had kept these instructions for a number of days we held the stock at 50 until the panic seemed to be lessening a bit and then we gave orders to scale down the price. Immediately the market dropped to 40. That shows how vicious that market was at that time and how heavy the volume. The period through which we held the price at 50 was about two weeks from October 29 until November 12 or 13. We knew all during that period that the minute we stopped buying at 50 the stock would tumble and that was what we were guarding against. We knew that except for our supporting bid the stock would sell much lower. This is proved by the fact that as soon as we eased our bid of 50 the stock dropped to 40. We knew that except for our bid at 50 the stock would be selling at a much lower price.

Earlier in the year 1929 we had acquired some stock under these circumstances: A high official of the company was considering
87 resigning from the company. He held a block of the common stock. The company wanted to get as much of this stock as possible into the hands of employees by having them invest in the company. This was a settled policy and in furtherance thereof we acquired a number of B common shares so as to have it on hand to exchange with that official for his A stock which we would then distribute to our employees at its cost to us. We therefore acquired on a

favorable market in March 1929 a number of Class B shares so as to have them on hand to exchange for Class A stock if that contingency should develop. This Class A stock we would then have available for distribution to our employees at its cost to us. The resignation did not take place; but that is the explanation for the purchase of 45,000 shares earlier in 1929, which is part of the total of 574,880 purchased in 1929.

The sales of the various lots of stock we had acquired at the different times indicated were carried out in this way: After we had got such stock, for the reasons I have given, we further carried out our policy of getting the stock into what we call "good hands" which means into the hands of investors instead of speculators, and into hands that were in position to be useful to the company and its brands, through their good will to forward its interests; and with the further view of protecting the company against situations like those we had been confronted with before, as I have outlined. So we proceeded to reissue such stock for cash as occasion presented.

In 1922 when our stock was listed on the Exchange, in our effort to widen our stockholding base, we had less than 2,000 stockholders of all classes of stock. The exact number was 1077. It was customary for companies the size of ours to have as many as 50,000. At the time of the market crash in 1929 we had only 9,136 of Class B stockholders. With our acquisitions of stock in the 1929 market panic we were able to distribute this stock so that by 1933 we had 41,000 stockholders and by 1936 we had 52,000. This was one of the things we were driving at in acquiring these blocks of stock. Companies comparable to ours had large stockholding lists. For example: In 1934 American Tobacco Co. had 48,750; Atchison, Topeka & Santa Fe R. R. had 39,000; New York Central had 59,000; Pennsylvania R. R. had 232,000; Southern California Edison had 48,000; Standard
88 Oil Co. (N. J.) had 134,000; General Foods had 60,000; National Dairy Products had 71,000; Baltimore & Ohio had 38,000; Montgomery Ward had 60,000; United States Steel had 191,000; American Telephone & Telegraph had 708,000. I do not claim a comparison is applicable between those large ones.

No sales of stock in 1929 involved any acquisitions of stock between the years 1921 and 1929. Other dispositions were made in the intervening years, as noted in paragraph 12 of the stipulation. All of them were made for the same reasons of policy which was to extend our stockholding base and to preserve the reputation of the company's stock and by that means to preserve the company's reputation. I was general counsel of the company during those years and the question was submitted to my department as to whether these purchases could be made under such a policy, and it was the view of the executives and the law department that since this policy involved the reputation of the company and of the stock, its brands and the general welfare of its stockholders, the company should go forward with this policy and buy such stock. The Company's charter did not authorize the company to deal in stock but it was our opinion that the contemplated

transaction was not a matter of dealing in stock but was a pursuit of a general policy of the company. In the absence of specific authority to do this kind of thing, each situation that resulted in a desire or a question on the part of the executives as to whether or not they should go forward and acquire some of this stock had to be submitted to the law department and a ruling obtained as to whether or not under those particular circumstances the company could, in the absent of an authorization to deal in stock, acquires shares of its stock. This was done in each case that presented any different situation or set of facts from the last one on which the question arose, that is, my department each time made a ruling as to whether, under the particular circumstances of that case, the company could make these transactions in view of the absence of charter authorization.

We acquired 21,000 shares for cash and reissued the same within the year for cash in an amount in excess of the cash we had put out in the acquisition. In every transaction the stock was issued or reissued for cash received into the company's treasury. Whether this
89 was a sale or not, I don't know. We had acquired every such share for cash and we reissued it for cash received. The market shows that in 1924 ten typical tobacco stocks (including our own) had a high market early in that year and then during the first quarter it dropped very substantially. During the second and third quarters there was an upward movement. We took advantage of that upward movement between June and August. People who want to buy stocks will buy them when the market is starting up and they won't buy when the market is flat or working down. So when the market was upward we could market our stock without injury to the reputation of our stock, whereas we would injure it if we tried to distribute it in a weak or downhill market. In such a market every share that was offered would just kick it that much further downhill.

This question of preserving the reputation of the company's stock does not mean solely that you keep it from going up or down. It includes something else. It includes having the stock behave itself in a way that its reputation is not injured by its movements in comparison with the movements of comparable stocks. It means such a behavior as will not hurt the reputation of the stock. If we had put enough stock into the market at one time to hold that stock, even though we did not force it down we would have made it impossible for comparable stocks to run away from it. We did not want our stock run down and we did not want it to lose step with other comparable stocks.

In 1924 we disposed of 21,067 shares of the stock acquired in 1921 from United Retail group. The sales we made in 1925 were from the stock we acquired in 1921 from United Retail Stores. In the early part of 1925 there had been a slight advance and then a steep drop in the market. Then the market started up gradually and kept rising during the rest of the year. All stocks were moving upward. Again we took advantage of this situation to issue additional stock without hurt-

ing the position of our stock on the market or the reputation of the company. We had to go very slowly because, as I explained as to 1924, we had to avoid running our stock down and thereby injuring its reputation.

Special circumstances were involved in the 1926 transactions. In that year there was a purchase as well as *as* a sale of a block of
90 stock. The circumstances were that there was a charter amendment in 1926, and by reason of this amendment the management of the company feared the speculators on the market might start a rumor that petitioner would declare a stock dividend. Such a rumor was unfounded but the management desired to protect the company and its stock against such rumors and thereby to protect the reputation of the stock by keeping it from jumping and precipitantly dropping. Accordingly petitioner purchased a block of its stock for cash and after the rumor had passed these shares were gradually reissued for cash. Thereby the company saved the reputation of its stock in the same manner as previously recited.

In 1927 the only transaction this company had, respecting its stock, consisted of a disposition of certain fractional shares which accrued to it in connection with the issuance of stock rights. These worked out into fractions. Some of the people entitled to these rights failed to exercise them within the time prescribed. In the year 1927 the company made disposition of these rights for cash.

In 1928 the company reduced the price of its cigarettes from $6.40 to $6.00 per thousand. Following that reduction a great many holders of our stock began to offer for sale on the market and this greatly multiplied the volume of stock which the market was called upon to absorb. Our stockholders list was even then not large enough to absorb the excessive offers.

In view of that situation, and with the same view of protecting the reputation of the stock of the company and its business and its brands, and with plenty of cash on hand at the time we again undertook to acquire on the market for cash certain shares of our stock, protecting that market against the precipitant fall in price which we thought would result if we did not take that action. After that situation had been taken care of the market steadied itself so that we were able to reissue the stock that we had acquired and save that special situation. That accounts for the item listed in the stipulation as to the year 1928, except that along with that item and accounting for part of it, was a disposition in the year 1928 of 1,250 shares of the stock acquired from United Retail Stores in the year 1921. The two items I have referred to account in full for the figures listed in
91 section 12 of the stipulation regarding the year 1928. A rising market in the latter part of 1928 afforded an opportunity to further widen the stockholding base of the company, for the reason that we had a considerable number of shares on hand at that time. That situation in 1928 presented, as we saw it, a perfect opportunity for the practicing of the policy which we had been pursuing. For a

94 The foregoing has been examined and compared with the transcript by counsel for respondent (appellee) who agrees that it contains the substance of all the testimony given at the hearing of this proceeding and consents to the foregoing as the statement of the evidence herein.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Approved and ordered filed this 2nd day of December 1937.

ERNEST H. VAN FOSSAN,
Member, U. S. Board of Tax Appeals.

Respondent's Exhibit E

U. S. Board of Tax Appeals, Div. 9, Docket 71901

Admitted in Evidence Apr. 27, 1936

R. J. REYNOLDS TOBACCO COMPANY, WINSTON-SALEM, N. C.

FINANCIAL STATEMENT

December 31, 1929

WINSTON-SALEM, N. C., *January 14, 1930.*

To the Stockholders of R. J. Reynolds Tobacco Company:

The Financial Report of your Company, at the close of business December 31, 1929, is hereby submitted.

Net Earnings for the year 1929, after deducting all charges and expenses of management, and after making provision for	
95 Interest, Taxes (including Federal and State Income Taxes), Depreciation, Advertising, etc	$32,210,521.27
Deduct:	
Three quarterly dividends of sixty cents each and one quarterly dividend of seventy-five cents per share	25,500,000.00
Balance carried to Undivided Profits	6,710,521.27
Add: Undivided Profits December 31, 1928	44,869,338.02
Total Undivided Profits December 31, 1929	$51,579,859.29

Financial Statement, December 31, 1929

ASSETS

Current:		
Cash	$18,139,801.33	
Accounts Receivable (net) for merchandise sold	11,426,731.03	
Leaf Tobacco, Supplies, Manufactured Product	90,965,963.80	$120,532,496.16

Other assets:			
Real Estate, Buildings, Machinery, Fixtures		$25,211,769.37	
Deduct Depreciation, Obsolescence, etc	$9,118,054.82		
Less fully depreciated property written off during year	1,359,565.07	7,758,489.75	
		17,453,279.62	
Investments in Non-Competitive Companies, etc		19,601,594.77	
Bills and Notes Receivable		329,918.62	
Other Accounts Receivable		4,637,927.30	
Brands, Trade-Marks, Good Will		1.00	
Prepaid Expenses		581,135.60	$42,653,856.91
			$163,186,353.07

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LIABILITIES

Current:			
Accounts Payable		$3,783,321.26	
Accrued Taxes and other Accrued Accounts		5,993,649.07	$9,776,970.33
Reserves: Contingencies			1,829,523.45
Capital Account:			
Common Stock		10,000,000.00	
New Class B Common Stock		90,000,000.00	
Undivided Profits (after deduction of dividends payable January 1, 1930)		51,579,859.29	151,579,859.29
			$163,186,353.07

Respectfully,

R. D. SHORE, *Treasurer.*

We hereby certify that we have examined the books of account and record of R. J. Reynolds Tobacco Company, Winston-Salem, N. C., at December 31, 1929, and it is our opinion that the above statement shows the true financial condition of the Company at the date stated, and that the accompanying Analysis of Undivided Profits Account is correct. Inventories of Leaf Tobacco, Supplies, Manufactured Product and Investments are valued at cost as in former years. As far as we could ascertain there were no contingent liabilities and we were informed none existed.

ERNST & ERNST,
Certified Public Accountants.

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Petitioner's Exhibit 3

U. S. Board of Tax Appeals, Div. 9, Docket 71901

Admitted in Evidence Apr. 27, 1936

Existing Charter of R. J. Reynolds Tobacco Company, September 28, 1931

Charter as Amended of R. J. Reynolds Tobacco Company

This is to certify that we, R. J. Reynolds, W. N. Reynolds, J. B. Duke, J. B. Cobb, Geo. M. Gales, C. K. Faucette, and D. A. Keller do

hereby associate ourselves into a corporation under and by virtue of the provisions of an Act of the legislature of the State of New Jersey, entitled "An Act Concerning Corporations, Revision of 1896", and the several supplements thereto and acts amendatory thereof, for the purpose hereinafter mentioned, and to that end we do by this, our Certificate, set forth:

First: That the name which we have assumed to designate such corporation, and to be used in its business and dealings, is "R. J. Reynolds Tobacco Company."

Second: The location of the principal office of such corporation in the State of New Jersey, is at No. 765 Broad Street, in the City of Newark, in the County of Essex. The name of the agent
98 therein, and in charge thereof, upon whom process against such corporation may be served, is J. Bayard Kirkpatrick.

NOTE.—The location of the principal office of R. J. Reynolds Tobacco Company, in the State of New Jersey, is now at No. 75 Montgomery Street, Jersey City, N. J. The name of the agent therein and in charge thereof, upon whom process against such corporation may be served is Henry A. Cetjen. This change was duly made on the 17th day of January 1921.

Third: The objects for which this corporation is formed are to cure leaf tobacco and to buy, manufacture and sell tobacco in any and all its forms; and to erect or otherwise acquire, factories and buildings, establish, maintain, and operate factories, warehouses, agencies, and depots for the storing, preparation, cure, and manufacture of its tobacco, and for its sale and distribution, and to transport or cause the same to be transported, as an article of commerce, and to do any and all things incidental to the business of trading and manufacturing aforesaid.

This corporation shall also have power to conduct its business or any portion of it in all other states and territories, colonies and dependencies of the United States of America and Great Britain and Canada and all other foreign countries, to have one or more offices out of the State of New Jersey, and to hold, purchase, lease, mortgage, and convey real and personal property out of the State of New Jersey, as well as in said State.

Fourth: The total amount of the authorized capital stock of the Corporation is One Hundred Forty Million Dollars ($140,000,000) divided into Fourteen Million (14,000,000) shares of the par value of Ten Dollars ($10.00) per share, of which total authorized capital stock, One Million (1,000,000) shares amounting at par to Ten Million Dollars ($10,000,000) shall be Common Stock and Thirteen Million (13,000,000) shares amounting at par to One Hundred Thirty Million Dollars ($130,000,000) shall be New Class B Common Stock.
99 The One Million (1,000,000) shares of Common Stock of the par value of Ten Dollars ($10.00) per share shall be reserved and used only for the purpose of substitution for the present outstanding Four Hundred Thousand (400,000) shares of Common Stock of the par value of Twenty-Five Dollars ($25.00) per share

upon the basis of Two and one-half (2½) shares of said Common Stock of the par value of Ten Dollars ($10.00) per share for each outstanding share of said Common Stock of the par value of Twenty-Five Dollars ($25.00) per share, said exchange to be made at such time and in such manner as the Directors of the Company may determine.

Nine Million (9,000,000) shares of the Thirteen Million (13,000,000) shares of New Class B Common Stock of the par value of Ten Dollars ($10.00) per share shall be reserved and used only for the purpose of substitution for the outstanding Three Million Six Hundred Thousand (3,600,000) shares of New Class B Common Stock of the par value of Twenty-Five Dollars ($25.00) per share upon the basis of Two and one-half (2½) shares of said New Class B Common Stock of the par value of Ten Dollars ($10.00) per share for each outstanding share of said New Class B Common Stock of the par value of Twenty-Five Dollars ($25.00) per share, said exchange to be made at such time and in such manner as the Directors of the Company may determine.

The New Class B Common Stock shall have the same rights and privileges as the Common Stock of the Company except that it shall not have any voting power and except further that it shall not be considered under the Company's plan providing for participation by officers and employees in certain profits of the Company.

The amount of capital stock with which the Corporation will commence business is Fifteen Hundred Dollars ($1,500) of Common Stock.

Fifth: The names and Post-office addresses of the incorporators and the number of shares subscribed for by each, the aggregate of such subscriptions being the amount of Capital Stock with which this Company will commence business, are as follows:

100 Name	Post-office Address	Shares
R. J. Reynolds,	765 Broad Street, Newark, N. J.	2
W. N. Reynolds,	765 Broad Street, Newark, N. J.	2
J. B. Duke,	765 Broad Street, Newark, N. J.	3
J. B. Cobb,	765 Broad Street, Newark, N. J.	3
Geo. M. Gales,	765 Broad Street, Newark, N. J.	2
C. K. Faucette,	765 Broad Street, Newark, N. J.	2
D. A. Keller,	765 Broad Street, Newark, N. J.	1

Sixth: Meetings of the Board of Directors need not be held in the State of New Jersey, but may be held in such place or places in any other State, or States, as the By-Laws of the Corporation may from time to time provide. The Corporation may, through its Board of Directors, acquire and undertake the whole or any part of the business, property, assets, contracts and liabilities of any person, firm, or corporation, if the same are, in their judgment, useful in the business of this Corporation.

The Board of Directors shall have the power by vote of a majority of all the Directors and without assent or vote of the stockholders, to make, alter, amend and rescind the By-Laws of this Corporation, to fix the amount to be reserved as working capital, and to fix what number of Directors shall constitute a quorum of the Board.

Seventh: The existence of this Corporation shall commence on the date of the filing of this certificate, in the office of the Secretary of State of New Jersey, and shall continue perpetually.

In witness whereof, we have hereunto set our hands and seals the third day of April, A. D., 1899.

R. J. Reynolds. [SEAL]
W. N. Reynolds. [SEAL]
J. B. Duke. [SEAL]
J. B. Cobb. [SEAL]
Geo. M. Gales. [SEAL]
C. K. Faucette. [SEAL]
D. A. Keller. [SEAL]

(10c I. R. Stamp Can.)

101 Signed, sealed, and delivered in the presence of S. B. Goodale.

State of New York,
City and County of New York, ss:

Be it remembered, that on this third day of April, eighteen hundred and ninety-nine, before me, S. B. Goodale, a Commissioner of the State of New Jersey, in New York, personally appeared R. J. Reynolds, W. N. Reynolds, J. B. Duke, J. B. Cobb, Geo. M. Gales, C. K. Faucette, and D. A. Keller, known to me to be the individuals described in, and who executed the foregoing Certificate, and I having first made known to them the contents thereof, they did each acknowledge that they signed, sealed, and delivered the same as their voluntary act and deed.

In witness whereof, I have hereunto set my hand and affixed my official seal this third day of April A. D., 1899.

[SEAL] S. B. Goodale,
Commissioner of New Jersey,
Resident in New York.

(10c I. R. Stamp Can.)

[Endorsed:] "Received in the Clerk's office of the County of Essex on the third day of April A. D., 1899, and recorded in Book 16 of Incorp. Bus. Cos. for said County, page 117, &c. William O. Kuebler, Clerk. Filed April 4, 1899. George Wurts, Secertary of State."

Note.—Charter amended February 21, 1906, by increasing
102 Authorized Capital Stock from $5,000,000 to $10,000,000, said increase being 50,000 shares of Common Stock at par value of $100 each.

Charter amended April 2, 1913, by increasing Authorized Capital Stock from $10,000,000 to $20,000,000, said increase being 100,000 shares of 7% Cumulative Preferred Stock at par value of $100 each.

Charter amended November 26, 1917, by increasing Authorized Capital Stock from $2,000,000 to $40,000,000, said increase consisting of 100,000 shares of 7% Cumulative Preferred Stock at par value of $100.00 each and 100,000 shares of Class B Common Stock at par value of $100 each.

Charter amended June 24, 1920, by reducing par value of the common stocks from $100 to $25 and increasing the Authorized Capital Stock from $40,000,000 to $140,000,000, said increase consisting of 300,000 shares of 7% Cumulative Preferred Stock at par value of $100 each, and 2,800,000 shares of New Class B Common Stock, par value of $25 each.

Charter amended April 15, 1926, by changing the $60,000,000 of authorizations of the Certificate of Incorporation for Preferred Stock and Class B Common Stock, $100 par, into an authorization for 2,400,000 shares of New Class B Common Stock of the par value of $25.00 per share and identical with the existing New Class B Common Stock of the Company.

Charter amended December 28, 1928, by reducing the par value of Common and New Class B Common Stock from $25.00 per share to $10.00 per share.

State of New Jersey, Department of State

I, Thomas A. Mathis, Secretary of State of the State of New Jersey do hereby Certify that the foregoing is a true copy of Certificate of Incorporation of "R. J. Reynolds Tobacco Company," Amended to date----------
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---and the endorsements thereon, as the same is taken from and compared with the original filed in my office on the Fourth day of April A. D. 1899, and now remaining on file and of record therein.

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In testimony whereof, I have hereunto set my hand and affixed my Official Seal at Trenton, this Twenty-ninth day of September A. D. 1931.

[SEAL]

THOMAS A. MATHIS,
Secretary of State.

In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Praecipe for transcript of record

Filed December 2, 1937

To B. D. GAMBLE,
Clerk, United States Board of Tax Appeals:

SIR: It is requested that you prepare a transcript of the record in this cause, as required by law and the rules of the Board and the rules of the United States Circuit Court of Appeals for the Fourth Circuit, under the appeal heretofore perfected in the above-entitled cause, and include in said transcript the following documents:

1. The docket entries in this proceeding in the Board.
2. The Pleadings in the Board, including:
   (a) The Petition.
104 (b) The Answer.
   (c) The Amended Answer filed by respondent.
   (d) Petitioner's re'ly to Amended Answer.
   (e) Respondent's Rejoinder to Petitioner's Reply.
3. Stipulation of Facts filed by the parties in the Board, together with exhibits attached thereto, namely, Exhibits A, B, C, and D.
4. Agreed Statement of the Evidence.
5. Respondent's Exhibit E.
6. Petitioner's Exhibit No. 3.
7. Findings of Fact and Opinion of the Board, promulgated April 27, 1937.
8. Decision of the Board entered July 16, 1937.
9. The Petition for Review filed by the petitioner, together with notice of filing thereof and acknowledgment of service thereof by respondent, on October 12, 1937.
10. This Praecipe.

J. G. KORNER, Jr.,
D. H. BLAIR,
M. A. BRASWELL,
Attorneys for Petitioner-Appellant.

Service of above Praecipe acknowledged.
No counter praecipe will be filed.
This 2d day of December, 1937.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

105 [Clerk's certificate to foregoing transcript omitted in printing.]

107 In United States Circuit Court of Appeals for the Fourth Circuit

No. 4290

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

Docket entries

December 16, 1937, the transcript of record is filed and the cause docketed.

December 16, 1937, certified copy of order extending to December 20, 1937, the time for transmission and delivery of the record is filed.

Same day, the appearance of J. Kilmer Korner, Jr., David H. Blair and M. A. Braswell is entered for the petitioner.

December 22, 1937, the appearance of J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Philip M. Clark, Special Attorney, Bureau of Internal Revenue, is entered for the respondent.

108 January 12, 1938 the appearance of James W. Morris, Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, is entered for the respondent.

January 13, 1938, twenty-five copies of the printed record are filed.

February 12, 1938, stipulation as to respondent's brief is filed.

March 18, 1938, stipulation as to respondent's brief is filed.

April 2, 1938, the appearance of J. Louis Monarch and Morton K. Rothschild, Special Assistants to the Attorney General, is entered for the respondent.

April 16, 1938, petition of Cravath, de Gersdorff, Swaine & Wood for leave to file a brief as amici curiae filed.

April 16, 1938, order granting leave to Cravath, de Gersdorf, Swaine & Wood to file a brief as amici curiae filed.

ARGUMENT OF CAUSE

April 19, 1938 (April term, 1938), cause came on to be heard before Parker and Soper, Circuit Judges, and Way, District Judge, and is argued by counsel and submitted.

109 May 18, 1938, petition of petitioner for leave to file authorities filed.

May 18, 1938, order granting petitioner leave to file two certain opinions issued on May 10, 1938, by the Securities and Exchange Commission and to call to the attention of the Court two further authorities having a bearing on the issue present in this cause filed.

May 31, 1938, motion of petitioner for leave to file authorities filed.

May 31, 1938, order granting leave to petitioner to file a supplemental memorandum calling the Court's attention to the decision of the Ninth Circuit Court of Appeals in the case of Commissioner vs. Wilshire Oil Co., Inc., 96 Fed. (2) 971, filed.

110 In United States Circuit Court of Appeals, Fourth Circuit

No. 4290

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

(Argued April 19, 1938. Decided June 6, 1938)

Before PARKER and SOPER, Circuit Judges, and WAY, District Judge

J. G. Korner, Jr. (D. H. Blair and M. A. Braswell on brief), for Petitioner, and Morton K. Rothschild, Special Assistant to the At-

torney General (James W. Morris, Assistant Attorney General, and J. Louis Monarch, Special Assistant to the Attorney General, on brief), for Respondent. Cravath, DeGersdorff, Swaine & Wood; Wm. D. Whitney, Richard H. Wilmer, and Joseph C. White on brief as amici curiae.

Opinion

Filed June 6, 1938

111 SOPER, Circuit Judge: The petition in this case seeks a review of a decision of the Board of Tax Appeals wherein a deficiency in income tax of R. J. Reynolds Tobacco Company in the amount of $37,865.62 for the year 1929 was determined. The determination was based upon a profit of $286,581.21 realized by the corporation during the year from sales of its own class B common stock and was in conformity with the 1934 amendment of Article 66 of Treasury Regulations 74 relating to the Revenue Act of 1928, 45 Stat. 791. The original regulation which was in force from 1918 to 1934 broadly declared[1] that a corporation realizes no gain or loss from the purchase or sale of its own stock; but the amendment of May 2, 1934,[2] stated
112 that the real nature of the transaction determines the question whether the acquisition or disposition by a corporation of shares of its own stock gives rise to taxable gain or deductible loss; and where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

The cause originated in a 60 day notice of deficiency mailed to the taxpayer on April 3, 1933, upon which the taxpayer filed a petition for review with the Board. The matter involved had no relation to the present controversy and was adjusted by agreement; but in 1936 before the agreement was formally filed with the Board, the Commis-

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[1] Sale by Corporation of Its Capital Stock.—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. Treasury Regulations 74, Article 66.

[2] Acquisition or Disposition by a Corporation of Its Own Capital Stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes. Treasury Regulations 77, Article 66 as amended by T. D. 4430.

sioner filed an amended answer wherein he set up his present contention as an affirmative issue. The majority of the Board was of the opinion that the broad statement in the original regulation that a corporation realizes no gain or loss from the purchase or sale of its own stock was at variance with section 22 (a)[5] of the Revenue Act of 1928 which defines gross income to include gains, profits, and income derived from sales or dealings in property, or from any source whatever; and that the amended regulation was a correct interpreta-
113 tion of the statute. The evidence showed that the corporation had engaged in the purchase and sale of its own stock, usually to its own profit, on numerous occasions during the period 1921 to 1929, and the Board therefore held that the gain derived from this source in 1929 was taxable.

The taxpayer in this petition for review contends (1) that the regulation in force in 1929 was in harmony with established principles of law and of accountancy and constituted a correct interpretation of section 22 (a) of the Revenue Act of 1928; and (2) that even if this interpretation was open to doubt, it was not so patently wrong as to be without a reasonable basis; and therefore it should be applied to a transaction which occurred in 1929, because it represented the administrative construction uniformly given to the Act from 1918 to 1934, during which period the definition of income was reenacted in succeeding federal revenue acts[6] in substantially the same form as it is found in the Revenue Act of 1918, so that we should infer that the regulation correctly expressed the legislative intent.

The facts, set out in detail in the findings of the Board, 35 B. T. A. 949, may be summarized for our present purposes: The Tobacco Company has been engaged in the manufacture and sale of tobacco products in North Carolina since 1899. The capital structure has been changed from time to time by increases in the capital stock, the issuance of a class of common stock known as Class B, by stock dividends and by the reduction in par value of the common stock. The capital in 1929 was $100,000 000. consisting of $10,000,000. of $10. par common stock and $90,000,000. of $10. par Class B common stock. The latter class has no voting power and is not considered in the company's plan for profit sharing by its officers and employees.

114 The founder and principal stockholder at the beginning was R. J. Reynolds, whose policy was to bring as many employees as possible into the company as shareholders, entitled as such to a special annual distribution based on the profits realized. After 1912 the extension of the business was so rapid that new capital was nec-

[5] Sec. 22. Gross Income. (a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. 45 Stat. 791, 797.

[6] Sec. 213 (a) of the Revenue Acts of 1918, 1921, 1924, and 1926, 40 Stat. 1057, 42 Stat. 227, 43 Stat. 253, 44 Stat. 9. Sec. 22 (a) of the Revenue Acts of 1928, 1932, and 1934, 45 Stat. 791, 47 Stat. 169, 48 Stat. 680.

essary, but at the same time the management desired to protect the reputation of the company and the behavior of the stock on the market. The Class B common stock was first issued in 1918. In the same year Reynolds died and the sale of a substantial portion of his stock to several stockholders became necessary. In 1921 this stock was finally concentrated in a single corporation that was a large distributor of Reynolds products. Thereby a situation disturbing to other distributors was created, and the management determined to buy the stock and sell it to the public, thus ridding itself of a harmful influence and broadening its stockholding base at one and the same time. Accordingly the stock was bought and as the result of this purchase and certain subsequent transactions the company came into possession of 75,000 shares of Class B common stock which it held until January 31, 1929.

During the years 1921 to 1929 the company availed itself of all opportunities of broadening its stockholding base. The result was that the number of stockholders of all kinds of stock was increased from less than 2,000 in 1922 to 9,136 holders of Class B stock alone in 1929; and this number was increased to 52,000 in 1936.

Portions of the Class B stock that were bought in 1921 were sold as follows: 21,067 shares in 1924 and 11,000 shares in 1925, both on a rising market. In 1926, in order to protect the reputation of the stock and to prevent wide variations in prices that were feared, the taxpayer bought 21,400 shares of its stock and later gradually fed it back into the market. In 1928 the price of cigarettes was
115 reduced and the volume of stock offered for sale by stockholders was greatly increased. In order to protect the stock, the taxpayer bought 43,300 shares and after the market steadied, fed them back, together with 1,240 shares which had been bought in 1921. During each of the years 1924 to 1928, the taxpayer reissued for cash, shares of Class B common stock theretofore acquired for cash, in the manner similar to that set forth below with respect to the year 1929, and for like reasons, and the income tax return for each year showed a substantial profit on the transactions which was carried in the return as non-taxable income.

As has been stated, the taxpayer had 75,000 shares of Class B common stock by January 31. 1929. A certificate for 15,000 shares of this stock was cancelled and new certificates were issued to various persons who paid therefor $708,690. These shares had been acquired in 1921 at a cost of $121,440.19. During 1929 the taxpayer also sold 194,000 shares which it had purchased in that year—94,500 shares at $4,506,497, which had cost $4,908,966.17, and 99,500 shares at $4,703,608, which had cost $4,601,807.43. On December 18, 1929, 23% of the total outstanding shares of Class B common stock were in the hands of brokers subject to trading or speculation and were in a position to do great injury to the taxpayer and its business. At the time of the break in the market in 1929 the company had $29,000,000 in cash and government securities, and the management determined to use these funds in purchasing the taxpayer's stock offered on the

market during October and November, 1929. By purchasing 90% of its stock thus offered, the taxpayer was able to hold the market price at $50. As the panic eased, the prices were scaled down to $40 and $39. During the year it purchased a total of 574,680 shares of its own stock.

At all times during 1929, the stock books and records of the taxpayer indicated that the number of Class B common stock
116 issued and outstanding was 9,000,000 shares. When shares of this stock were purchased by the company, the certificates were regularly entered on the balance sheets of the financial statement of the taxpayer under the entry "investments in Non Competitive Companies" at the amount of cash for which they were acquired; and they were so carried until the certificates were cancelled and new certificates were issued to purchasers in lieu thereof. The transactions of purchase and sale were not recorded so as to indicate either an increase or a reduction of the number of the outstanding shares. The cash of the taxpayer was reduced by the amounts expended in the purchases, and increased by the amounts received in the sales of the stock. At the close of the taxable year 1929, the taxpayer had on hand 431,929 shares of its Class B common stock; and these shares represented $19,270,690.98 out of a total of $19,601,594.77 appearing on the taxpayer's books as investments in non-competitive companies. The taxpayer's income tax return for the year indicated a non-taxable profit from dealings in its own stock of $436,581.21 which was carried on the books as a cash item in the surplus account in accordance with the taxpayer's understanding of the situation and the Treasury Department regulation in force at the time. It is estimated that the amount of the item should be reduced to $286,581.21.

During a period of sixteen years from 1918 to 1934, the regulations, rulings, and decisions of the Treasury Department and the decisions of the Board of Tax Appeals supported the interpretation of the statute for which the taxpayer now contends. They were based upon the theory that when a corporation issues shares of its stock for the money or property of another person, or acquires such stock in exchange for its own money or property, there takes place a capital transaction which involves a readjustment of the capital structure, but
117 neither a taxable gain nor a deductible loss. Thus the regulations in force during the period expressly declared that "a corporation realizes no gain or loss from the purchase or sale of its own stock";[7] the rulings and decisions of the Treasury Department were in harmony with this pronouncement;[8] and the Board of Tax Appeals in a leading decision, Simmons & Hammond Mfg. Co., 1 B. T. A. 803

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[7] Regulations 45, Arts. 542 and 563, Rev. Act of 1918; Regulations 62, Arts. 543, and 563, Rev. Act of 1921; Regulations 65, Arts. 543 and 563, Rev. Act of 1924; Regulations 69, Arts. 543 and 563, Rev. Act of 1926; Regulations 74, Arts. 66 and 176, Rev. Act of 1928; Regulations 77, Arts. 66 and 176, Rev. Act of 1932; Regulations 33, revised, Article 98 promulgated under the Revenue Acts of September 8, 1916, and October 3, 1917, contained the statement that if treasury stock is resold at a price in excess of its cost upon repossession, such excess shall be returned as income.

[8] Law Opinion 296, 5 C. B. 210; Law Opinion 426, 5 C. B. 210; Law Opinion 1035, 2 C. B. 132, 133; Law Opinion 1035, revised, 3 C. B. 160, 162; A. R. R. 693, 5 C. B. 207; A. R. R. 799, C. B. I-1, 374; A. R. R. 8159, C. B. III-2, 256; I. T. 1198, C. B. I-1, 275; I. T. 1736, C. B. II-2, 274; I. T. 1802, C. B. II-2, 267; Solicitor's Memorandum 2205, C. B. III-2, 244.

(1925), held that a corporation which had 323 shares of stock outstanding experienced no deductible loss in the sale of 94 shares for less than the price at which they had been bought by the corporation a few months before.[9]

118 Writers upon the theory of accounting have given much consideration to the proper method of entering upon the records of a corporation purchases and sales by it of its own stock. It is quite generally said that stock purchased and held as treasury stock without retirement should not be treated as an asset but should be carried in the balance sheet as a reduction of capital or of surplus.[10] But it is freely admitted that the actual practice of many important businesses has been to the contrary;[11] and it has been suggested that the correct accounting for stock held in the treasury may be affected in

119 a given case by attendant circumstances, as for instance, that the amount involved is small in comparison with the total stock outstanding, or that marketable stock is being temporarily held for resale, as indicating that from a practical standpoint the capital structure is not materially affected. This viewpoint has all along been held by Montgomery.[12]

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[9] To the same effect was Cooperative Furniture Co., 2 B. T. A. 165. Similar rulings were made with regard to the purchase or sale by a corporation of its shares although at a price varying from that at which they had been previously issued or purchased by the corporation. Atlantic Carton Corp., 2 B. T. A. 380; Hutchins Lumber & Storage Co., 4 B. T. A. 705; Liberty Agency Co., 5 B. T. A. 778; J. H. Johnson, 19 B. T. A. 840, affirmed 58 F. (2d) 58; American Cigar Co., 21 B. T. A. 464, affirmed 66 F. (2d) 425; Carter Hotel Co., 25 B. T. A. 933, affirmed 67 F. (2d) 642; Ohio Central Telephone Co., 28 B. T. A. 96; and with regard to costs and expenses incurred in an issue of stock, Emerson Electric Co., 3 B. T. A. 932; Simmons Co., 8 B. T. A. 631, affirmed 33 F. (2d) 75; and with regard to partial payments forfeited to the corporation upon default in the payment of the full purchase price of stock, Illinois Rural Credit Assn., 3 B. T. A. 1178; Inland Finance Co., 23 B. T. A. 199, affirmed 63 F. (2d) 886; see also 105 W. 55th St. Inc., 15 B. T. A. 210, affirmed 42 F. (2d) 849.

The Board also applied the rule to the purchase by a corporation of the stock of an affiliated corporation, regarding them as a single entity under the statutes. Farmers Deposit Natl. Bank, 5 B. T. A. 520; Interurban Construction Co., 5 B. T. A. 529; Union Trust Co. of N. J., 12 B. T. A. 688. Recently similar decisions of the Board have been reversed by the courts on the ground that affiliated corporations are separate entities in law. Commissioner vs. VanCamp Packing Co., 67 F. (2d) 596; Commissioner vs. General Gas & Elec. Corp., 72 F. (2d) 364; Founders General Corp. vs. Commissioner, 79 F. (2d) 6. The rule of the Board was also applied in the later cases when the transactions involved a transfer of property as well as stock. Houston Bros. Co., 21 B. T. A. 804, overruling Reblow Estate Co., 12 B. T. A. 1365, and New Jersey Porcelain Co., 15 B. T. A. 1059; S. A. Woods Machine Co., 21 B. T. A. 818. Cf. Haskell & Barker Car Co., 9 B. T. A. 1087; see also Riggs Natl. Bank, 17 B. T. A. 615, affirmed 57 F. (2d) 980. The decision of the Board in S. A. Woods Machine Company was reversed on appeal as will hereinafter appear.

[10] George S. Hills on Stated Capital and Treasury Shares, Journal of Accountancy, Vol. 57, Jan. to June 1934, 202, 212, 213; Dickinson Accountancy Practice and Procedure, 120; Paton, Accountant's Hand Book, 931–2, 980–1; Wildman and Powell, Capital Stock Without Par Value, 93–4; Marple, Treasury Stock, Journal of Accountancy, Vol. 57, Jan. to June 1934, 257, 262–3; Sunley and Pinkerton, Corporation Accounting, 121; Kester, Accounting Theory and Practice, 17.

[11] See the articles by Hills and Marple, Supra. On May 10, 1938, the Federal Securities and Exchange Commission ruled that the excess of the proceeds of the sale of reacquired shares of a corporation's own stock over the cost thereof should be accounted for as capital since a transaction of this nature does not result in profit or surplus; and that from an accounting standpoint no distinction should be made between such a transaction and the reacquisition and retirement of such stock together with the subsequent issue of stock of the same class.

[12] Montgomery, Auditing Theory and Practice, 4th Ed., 1927, 245, 247. In the 5th Ed., 1934, 402, the author stated: "Proceeds of Sale of Treasury Stock.—When capital stock is donated to a corporation, the proceeds of its subsequent sale are capital. In the author's opinion, provided the laws of the state of incorporation permit, when stock is purchased in the open market and resold the profit or loss may be reflected in earned surplus since in such a case there is virtually no difference between dealing in its own stock and in the stocks or securities of other corporations. It has been urged that when a corporation purchases part of its stock, it is a capital transaction because its outstanding stock is reduced and its surplus increased or decreased; if stock is purchased below par, surplus is increased; if stock is purchased above par, surplus is reduced. When stock is purchased or acquired for permanent holding or for formal reduction of outstanding issues, it is proper to treat it as a capital transaction; but when a corporation buys a relatively small number, say 100 shares, of its own stock at $80 a share and immediately

When we come to the decisions of the courts we find support both for the view that treasury stock is in truth not an asset in the hands of a corporation; and also for the opinion that the real nature of the situation must be examined in order to determine whether gain or loss, recognizable by the taxing statutes, has occurred in the purchase or sale by a corporation of its own stock. Thus it was said by Judge Learned Hand in speaking of treasury shares in Borg vs. International Silver Co., 11 F. (2d) 147, 150:

"Such shares are of necessity retired in this sense: That they constitute no longer any liability of the defendant. A corporation
120 can have no right of action against itself, as must be if the share is truly a liability. Indeed the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch on the market, while the second has disappeared altogether. * * * To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant cannot collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry them as an asset at cost, providing, of course, all other assets are so carried. Even so, a company which revalued its assets might properly carry them at their sale value when the revaluation was made. In any event there can be no ambiguity in stating the facts more directly as the defendant did: that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal accounting or not."

The holding of the Board in Commissioner vs. S. A. Woods Machine Co., 21 B. T. A. 818, that in accordance with Regulations 65, Article 543, no taxable income resulted when a corporation accepted shares of its own stock in payment of damages due it for patent infringement was reversed in 57 F. (2d) 635. Adopting the realistic view of the problem the court said:

"Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved. Walville Lumber Co. vs. Com. of Internal Revenue (C. C. A.) 35 F. (2d) 445; Spear & Co. vs. Heiner (D. C.) 54 F. (2d) 134. If it was in fact a capital transaction, i. e., if the shares were acquired or parted with in connection with a readjustment of the capital structure of the
121 corporation, the Board rule applies. Doyle vs. Mitchell Bros. Co., 247 U. S. 179, 184, 38 S. Ct. 467, 62 L. Ed. 1054; Eisner

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sells it for $50 a share, the gain of $1,000 is no more a capital gain than if the purchase and resale were of any other security or commodity." See also Sunley and Pinkerton on Corporate Accounting, 123, 124; Dickinson, Accountancy Practice and Procedure, 117; R. E. Payne on Treasury or Reacquired Stock in the Certified Public Accountant February 1936, Vol. 16, 98–105; Esquerre, Practical Accounting Problems, Part II, 1922, 6–81.

vs. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. But where the transaction is not of that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income. The view taken by the Board of Tax Appeals (see Houston Brothers Co. vs. Commissioner, 21 B. T. A. 804) presses accounting theory too far in disregard of plain facts. It is not supported by any decision which has come to our attention except those of the Board.

* * * * * * *

The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as a debtor happended also to own the stock, the money payment and the purchase of stock were by-passed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid. The wide door to evasion of taxes opened by the decision of the Board is an additional reason, and a weighty one, against it."

See also Commissioner vs. Boca Ceiga Development Co., 66 F. (2d) 1104; Allyne-Zerk Co. vs. Commissioner (C. C. A. 6), 1936, 83 F. (2d) 525 Dorsey vs. Commissioner (C. C. A. 5) 1935, 76 F. (2d) 339, cer. den. 296 U. S. 589; Burnett vs. Riggs Natl. Bank (C. C. A. 4), 1932, 57 F. (2d) 980. See also the comment on Taxability of Transactions by a Corporation in Its Own Stock, 47 Yale L. J. 111.

It is manifest that the decision of the court in Commissioner vs. S. A. Woods Machine Co., supra, led to the promulgation of the amended regulation by the Secretary of the Treasury which now appears as Regulations 77, Article 66, wherein the Board
122 revised its former position and adopted the view that "whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction which is to be ascertained from all its facts and circumstances; * * *" and "where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another." [13]

Enough has been said to suggest that neither interpretation of the Act is without a reasonable basis. On the one hand, it is reasonable to say that when a corporation buys or sells its own stock, a change in its capital structure takes place; and that the change may be of material significance although purchases are followed by sales, if substantial

[13] The change had perhaps been foreshadowed in Houston Brothers Co. vs. Commissioner, 21 B. T. A. 804, 815, upon which the conclusion reached by the Board on the same day in S. A. Woods Machine Company, supra, was based, when the Board expressly declined to decide what rule should be applied in the case of a casual purchase and sale in the open market by a corporation of its own shares, nothing more being intended or accomplished than a temporary holding of the stock.

amounts of stock are involved and the stock is held in the treasury for substantial periods of time. On the other hand it may be said that the increase or decrease of net resources which often accompanies the purchase and sale of marketable stock bears strong resemblance to the gain or loss which the taxing statutes recognize; and this appears to be the more manifest when the change in the amount of outstanding stock is relatively small and the period during which it is held by the corporation as treasury stock is short. There is room for debate, and this situation determines the rationale of our decision in the pending case.

We do not undertake to say that the present regulation would not have been a correct interpretation of the statute, as applied to such facts as are now before us, if it had been promulgated in 1918.
123 But, as we have seen, the prevailing opinion in that year and thence continuously until 1934 forbad the taxation of such a profit as the Tobacco Company earned in 1929 in the sale of its own stock; and Congress in the light of this interpretation of its intent reenacted in substantially the same words the definition of income subject to tax in five successive carefully considered revenue acts. Our path is therefore clear; for the rule is well settled that if a statute is reasonably susceptible of two constructions, its reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place. The rule has been frequently applied in cases under the revenue acts when the statutory language is in general terms and susceptible of different interpretation as applied to the relevant facts; and in Johnson vs. Commissioner, 56 F. (2d) 58 (C. C. A. 5), 1932, it was applied to the very regulation now under consideration as set out in Regulations 62, Article 543 relating to the Revenue Act of 1921. See also United States vs. Alabama, Great Southern Ry. Co., 142 U. S. 615; Copper Queen Const. Mining Co. vs. Arizona, 206 U. S. 474; United States vs. Cerecedo, 209 U. S. 337; Brewster vs. Gage, 280 U. S. 327; McFeeley vs. Helvering, 296 U. S. 102; Helvering vs. Richmond, F. & P. R. Co., 90 F. (2d) 971.

In Mass. Mutual Life Ins. Co. vs. United States, 288 U. S. 269, 273, the court said:

"The Congress in the Revenue Acts of 1928 and 1932 reenacted Section 245 without alteration. This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (National Lead Co. vs. United States, 252 U. S. 140, 146; Poe vs. Seaborn, 282 U. S. 101,
124 116; McCaughn vs. Hershey Chocolate Co., 283 U. S. 488, 492; Costanzo vs. Tillinghast, 287 U. S. 341) unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it. Compare Louisville & N. R. Co. vs. United States, 282 U. S. 740, 757–8." Cf. Manhattan vs. Commissioner, 297 U. S. 129;

135; Koshland vs. Helvering, 298 U. S. 441, 446; Burnet vs. S. & L. Bldg. Corp., 288 U. S. 406; Murphy Oil Co. vs. Burnet, 287 U. S. [illegible] Helvering vs. Safe Deposit & Trust Co., Executor of Will of Henry Walter (C. C. A. 4), 95 F. (2d) 806.

The decision of the Board of Tax Appeals is reversed.

126 In United States Circuit Court of Appeals, Fourth Circuit

No. 4290

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed and Entered June 6, 1938

On petition to Review the Decision of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the United States Board of Tax Appeals for further proceedings in accordance with the opinion of the Court filed herein.

June 6, 1938.

MORRIS A. SOPER,
U. S. Circuit Judge.

127 On another day, to-wit, July 7, 1938, the mandate of this Court, in this cause, is issued and transmitted to the United States Board of Tax Appeals at Washington, D. C., in due form.

[Clerk's certificate to foregoing transcript omitted in printing.]

128 Supreme Court of the United States

Order allowing certiorari

Filed October 17, 1938

The petition herein for writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice STONE took no part in the consideration and decision of this application.

[Endorsement on cover:] File No. 42,813. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 328. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* R. J. Reynolds Tobacco Company. Petition for a writ of certiorari and exhibit thereto. Filed September 6, 1938. Term No. 328 O. T. 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1939